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# SMALL BUSINESS ADMINISTRATION'S SURETY BOND GUARANTEE PROGRAM

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## HEARING

BEFORE THE

## COMMITTEE ON SMALL BUSINESS UNITED STATES SENATE

NINETY-SEVENTH CONGRESS

SECOND SESSION

ON

SMALL BUSINESS ADMINISTRATION'S SURETY BOND GUARANTEE PROGRAM

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MARCH 11, 1982

Printed for the use of the Committee on Small Business

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# CONTENTS

Statement of Senators— Page
  Chiles, Hon. Lawton, a U.S. Senator from the State of Florida ........ 3
  Weicker, Hon. Lowell, Jr., a U.S. Senator from the State of Connecticut, and chairman, Committee on Small Business ........ 1
Statement of—
  Bedford, Mountie M., president, M B Underwriters, Pensacola, Fla ........ 352
  Boucher, Paul R., Inspector General, Small Business Administration ........ 255
  Douglas, William E., Commissioner, Bureau of Government Financial Operations [BGFO], Department of the Treasury, accompanied by Kenneth Schmalzbach, BGFO legal counsel; and Mary Casey, BGFO staff auditor ........ 305
  Holloway Edwin T., Associate Administrator for Finance and Investment, Small Business Administration, accompanied by Arthur E. Armstrong, Director, Office of Special Guarantees; and Robert B. Webber, Acting General Counsel, SBA ........ 442
  Magnotti Dr. John F., Jr., executive vice president, American Special Surety Council, accompanied by William Sommers, president, Surety Brokers of America; Mary Hunt, Bond Manager, American Druggists' Insurance Co.; Martin Cohen, president, Exchange Mutual Insurance Co.; Vincent Galvin, claims attorney, Vincent Galvin and Associates; and Mountie Bedford, president, M B Underwriters ........ 383

## APPENDIX

Letter dated March 9, 1982, to Senator Lowell Weicker, Jr., chairman, Senate Small Business Committee, from Richard M. Rangel, president, Peter and Rangel Construction Services, Inc., Rapid City, S. Dak ........ 482
Correspondence between the Senate Small Business Committee and Counsel for Market Insurance Corp ........ 483

## HEARING DATE

March 11, 1982:
  Morning Session ........ 1

# SMALL BUSINESS ADMINISTRATION'S SURETY BOND GUARANTEE PROGRAM

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## THURSDAY, MARCH 11, 1982

U.S. SENATE,
COMMITTEE ON SMALL BUSINESS,
*Washington, D.C.*

The committee met, pursuant to notice, at 9:30 a.m., in room 424, Russell Senate Office Building, Hon. Lowell Weicker, Jr., chairman of the committee, presiding.

Present: Senators Weicker and Rudman.

Also present: R. Michael Haynes, chief counsel; Marc Smolonsky, investigator; John G. McLean, professional staff member; Jack Gleason, professional staff member; and, Dorothy C. Olson, hearing clerk.

## STATEMENT OF HON. LOWELL WEICKER, JR., A U.S. SENATOR FROM THE STATE OF CONNECTICUT, AND CHAIRMAN, COMMITTEE ON SMALL BUSINESS

The CHAIRMAN. Today's hearing is based on a 5 month committee staff investigation of the Small Business Administration's surety bond guarantee program. The results of this investigation indicate that the program has lost millions of dollars due to fraud, mismanagement and negligence.

In 1980, this committee held two hearings on the SBA surety bond program. We heard testimony that SBA was approving bonds for small contractors without adequate documentation of need or capability; that SBA was paying losses without verification; and, that SBA was vulnerable to the most insidious types of fraud.

The committee also learned that an associate of organized crime had infiltrated the program, costing the SBA $3 million in losses. Today, we will hear testimony that criminal elements have again taken advantage of the surety bond program.

Furthermore, the committee's investigation has found that it is business as usual at SBA as far as the surety bond program is concerned. Despite the findings of 1980, there are still no procedures in place at the agency to prevent the kind of fraud and abuse witnesses will discuss today.

The SBA Inspector General will detail seven recent case studies which exemplify the types of problems plaguing the surety bond program. These seven cases alone represent more than $1 million in losses to the Government as a result of fraud by certain individuals and mismanagement on the part of SBA.

Frankly, I intend to see the program cleaned up once and for all. SBA has mismanaged the program for too long, and this committee can no longer tolerate such neglect.

I must emphasize that, despite the problems that will be revealed today, there is a real and fundamental need for the surety bond program. It has assisted thousands of small and minority business owners who could not otherwise have obtained contracts. Without this program, many small contractors would be squeezed out of the construction and service industries.

But I don't plan to stand by and let a corrupt few ruin this valuable program for those who truly need assistance.

I will release today a variety of factsheets and supporting documents prepared by the committee staff, as well as audits and investigative material supplied by the SBA Inspector General, which demonstrate the types of fraud and negligence that are costing the Government—and the taxpayers—needless dollars.

At this point, I will place into the record these factsheets and documents as well as a statement of Senator Chiles.

[Material follows:]

Lawton Chiles

# STATEMENT OF SENATOR LAWTON CHILES

March 11, 1982
Submitted to the Small Business Committee
of the United States Senate Washington, D.C.

Mr. Chairman and members of the Committee:

The Surety Bond guarantee program under the Small Business Administration is of tremendous importance to small businessmen in my state and around the country. The intent of Congress in entering this legislation was to strengthen the competitive free enterprise system by assisting qualified small business concerns to obtain certain bid, payment or performance bonds that would not be otherwise obtainable. The statutes authorized the Small Business Administration to guarantee Surety companies up to 90 percent of their losses incurred.

Although the Surety Bond Guarantee Program was adopted in 1972, it was not until December, 1976 that the figures were computerized and sorted. From the time that this data was first kept, until December 31, 1981, the Surety Bond Guarantee program produced nationally, guarantees on contracts awarded to small contractors in excess of 10.6 billion dollars with a loss ratio of less than 1.83%. It should be noted here that included in these figures are contracts awarded to Floridians amounting in excess of 541 million dollars. There is no loss ratio available on these Florida contracts, however, Region IV of the Small Business Administration, which encompasses Florida, Georgia, North Carolina, South Carolina, Tennessee, Kentucky, Alabama, and Mississippi, experienced a loss incurred percentage of approximately 1.72%; less than the national average.

These figures should lend themselves to the magnitude, scope and necessity of the Small Business Administration Surety Bond Guarantee Program, since the majority of all publicly funded contract work (e.g. Federal, State, County and City) requires contractors to seek these jobs by competitive bidding. These contractors must be bonded according to statute in the bidding phase, as well as during the actual construction.

Since the outset of the Small Business Administration Surety Bond Guarantee Program, the long range objective, that of helping the emerging and small contractor become more bondable in their own right and without the need of an SBA bond guarantee, has been demonstrated time and time again by graduating those that have proven themselves into the available Standard surety markets.

President Reagan in a letter dated October 18, 1980 to the American Special Surety Council recognized the value of the Small Business Administration Surety Bond Guarantee Program and was pleased the government is using the private sector to attain program goals.

> "This latter arrangement is entirely consistent with my policy to strengthen the role of the private sector, particularly small business, in order to increase jobs and cut the rate of growth in federal spending."

There were certainly many abuses within the program in its inception, but over the years it has become the most beneficial and advantageous program available to the private sector through the Small Business Administration.

Since the inception of this program, the contractor as well as the participating surety have encountered numerous amendments to the original conception, some favorable, some others unfavorable, but in general, regulations that do allow contractors to actively participate in competitive construction bidding. With the current major changes in policy, the contractor has now been limited in growth by reducing the size of an SBA guarantee to a maximum of $250,000.00 for any single contract or combination of contracts for the same contractor on a single contract of up to $1,000,000.00 In addition, the second major change now allows the contractor to grow by no more than 125% of his largest previously completed contract as opposed to standard guidelines offered by standard surety companies, growth of 200% of his largest previously completed job. Allowing a contractor to bid only 125% of the largest previously contract indicates that he/she may actually be losing ground, taking into consideration the extremely high inflation rate of labor and materials of the past few years.

The President's budget proposes a decisive reduction in the current and future allocations - from 1.6 billion to 1.4 billion by the Government Fiscal Year - end 1981 and further reductions from 1.4 billion to 1.08 billion by the Government Fiscal Year - end 1982. The fund created within the Treasury for this program is clearly stated as a revolving fund and is not being administered as such, causing these cutbacks to be paralyzing to the Small Business Administration Surety Bond Guarantee Program.

It is very possible that if the revolving fund was being administered as was intended by Congress, the current reduction in budgetary allocations may be digestable. That is to say, if the Small Business Administration would recognize the final release given them by the participating surety company and allow those funds to be reused on future guarantees, it may even be feasible to penetrate the budget still further. This is, however, not the case. The Small Business Administration Surety Bond Guarantee Program is currently debiting against their budgetary allocations their percentage of the contract guaranteed (80 or 90%) and upon notification by the surety of final completion of the said contract, consider the money "spent", never to be used again.

It is one thing to reserve an anticipated loss, but to dispose of the funds set aside on a contract that has been completed, where no further liability exists to the Small Business Administration, is not practical.

Taking into consideration ever increasing costs of construction and the current method of administering the fund, it should be obvious that regardless of the allocations for this program, there will never be sufficient funds to accommodate the needs of the small contractor in this program. Again, the problem is not with the total funding but rather with the program administration.

Since the Federal Government encourages the small business-person to participate in Federal Construction projects, as evidenced by the SBA 8(a) Program and the SBA Set-Aside Program, every administrative action taken by the agency should be geared toward assisting these firms.

Several years ago, the merits of the Small Business Administration Surety Bond Guarantee Program were being challenged Statistics gathered by Congressional subcommittees showed an overwhelming savings when publicly funded entities were able to award projects to small business contractors, bonded through the facilities of the Small Business Administration Surety Bond Guarantee Program. These savings were realized due to the fact that small contractors were able to pass along their lower overhead costs in their bid prices, as opposed to larger contractors with higher overhead and operating expenses.

Florida contractors are now being further jeopardized by the anticipation of losing their local Surety Bond Guarantee District Offices. Because of the immensity of Region IV of the SBA and the need to serve its residents in a more expeditious manner, the Region was originally decentralized. The Region established two separate and distinct District Offices here in Florida for processing Surety Bonds; one in Jacksonville to service the needs of contractors in the central and upper counties and the other in Coral Gables to service those remaining counties in lower Florida. The effect of decentralization has been excellent since it offers a competitive time frame in submitting cases for local contractors in the particular vicinity as opposed to submissions going all the way to the Regional office in Atlanta, Georgia. Since contractors very often have only a few days to apply for bid bonds, it will create an undue hardship if those precious few days are lost due to current mail time from Florida to Atlanta, Georgia.

It may be well to note that a recent comment made by the senior underwriter of one major convention market praised the Small Business Administration Surety Bond Guarantee Program as a way of educating small contractors to the professional requirements needed to graduate into the Standard Surety Market.

The SBA's Surety program has an appropriate role in assisting minority business firms in entering the mainstream of economic endeavors but with the kind of management application we've seen with this program a meaningful role is going to be virtually impossible. The point, Mr. Chairman, is not really the amount of money in the budget but rather the manner in which those funds are used. If the SBA will really treat the funds as a revolving account and the money is used, over and over again, then small businesses might just survive.

## FACT SHEET

| | |
|---|---|
| Principal: | Minority Builders, Incorporated<br>Gary, Indiana |
| Obligee: | Bergen Construction Company<br>Palatine, Illinois |
| Surety Bond Guarantee Number: | 500-56343-015-52 |
| Surety: | Heritage Insurance Company<br>Lincolnwood, Illinois<br>American Fidelity Fire Insurance Company<br>Woodbury, New York |
| Underwriter: | Transportation Motorists Association, Inc.<br>Chicago, Illinois |
| Claims Adjuster: | Melvin Dick<br>Chicago, Illinois |
| Completion Contractor: | State Construction Company<br>Chicago, Illinois |
| Cost of Original Contract: | $213,500 |
| Loss to SBA: | $231,477 |

## BACKGROUND

Bergen Construction Company received a $2.5 million contract from the City of Chicago to construct a police station in the City's North Side area. On October 28, 1976, Bergen subcontracted $213,500 of the work to Minority Builders, Incorporated to do concrete work on the project.

Heritage Insurance Company and American Fidelity Fire Insurance Company (AFF), co-insured the concrete subcontract with a bond guaranteed by SBA and issued on November 16, 1976.

Minority Builders grossly underbid the contract, and as a result, could not complete the project. The company went into default on September 9, 1977.

Heritage referred the default to claims attorney Melvin Dick. Under advisement from Dick, Heritage issued a $196,000 completion contract for the remaining concrete work to State Construction Company on September 26, 1977 even though the city estimated that completion of the contract would cost approximately $25,000.

State subsequently subcontracted the entire concrete completion project to Concrete Structures for $88,650. The subcontract was awarded on September 23, 1977, three days before State recevied its contract from Heritage. Concrete Structures completed the work without assistance from State.

## FINDINGS

The SBA Office of Inspector General conducted an audit of the completion contract, and upon discovering evidence of possible criminal fraud, referred the case to the Department of Justice. Staff of the Senate Small Business Committee also examined the case in preparation for an oversight hearing.

The initial investigation found that State Construction Company was a straw corporation created to act as a broker on construction contracts. Anthony Giacomino, the principal of State, is a known associate of organized crime figures in the Chicago area, according to files of the Chicago Crime Commission.

Melvin Dick, the claims attorney, represented to the surety that the completion contract received competitive bids. This was an allegedly fradulent representation. The Inspector General's investigation shows that State received the contract without competitive bidding.

Progress payments by the City of Chicago indicate that the completion cost of the concrete work should have been $25,000 plus remobilization expenses. This amount differs substantially from the $196,000 price of the contract given to State.

The subcontract between State and Concrete Structures was for $88,650, leaving State a profit of $107,350. Moreover, the direct cost of Concrete Structures to complete the contract was only $53,000.

Records of Dick contain three altered documents which fasely purport that State acquired certain materials for the concrete work. One such document was allegedly altered upward by $30,000.

Giacomino has been convicted of arson charges. He is also under indictment on fraud charges related to a contract with the City of Chicago for snow removal.

More recently, a Federal Grand Jury in Chicago has indicted Giacomino and Dick on 11 counts of mail fraud and nine counts of knowingly giving false statements related to this completion contract. The indictments charge them with devising a scheme to defraud Heritage, AFF and the SBA.

The indictment charges that Giacomino and Dick defrauded the surety's and the Federal Government by "rigging bids and executing a contract for the completion of the Far North Police Station concrete work at a falsely and fraudulently inflated price."

The indictment further charges that they "falsely reported to Heritage and to the SBA that bids had been solicited and received prior to the award of the completion contract, and that State Construction was the lowest bidder at $196,000, when in truth and in fact no true, genuine, and competitive bids had been either solicited or received for said contract."

The indictment also states that Dick and Giacomino altered waivers of lien executed by the subcontractor, Concrete Structures, to make it appear as if cement had been sold to State, and that cement was supplied for the completion work at a price substantially in excess of the amount actually paid.

Another charge contained in the indictment is that Giacomino, through a company called Green Lakes Landscaping, supplied expensive landscaping work to the personal residence of Dick, free of charge.

Giacomino and Dick have been arraigned, and will be tried in Federal Court.

SMALL BUSINESS ADMINISTRATION

## SURETY BOND GUARANTEE UNDERWRITING REVIEW

American Fidelity Fire Ins.
Co. / Heritage Ins. Co. of America

Minority Builders, Inc.
1525 Clark Road
Gary, Indiana 46404

Linda & Dock Miller

[illegible]

A. CREDIT REVIEW

Concrete work for the far North District Police Station 6461 N. Clark St., Chgo., Illinois Obligee: Bergen Construction Co., 55 W. Wood St., Palatine, Illinois

| | | | |
|---|---|---|---|
| $213,300.00 | $213,300.00 | ☐ YES ☒ NO | |
| ☒ YES ☐ NO | | Nov. 2, 1976 | April 11, 1977 |

$140,285.00 40% complete (not bonded)/Amoco Oil Co. Whiting, Ind

| | | |
|---|---|---|
| ☒ YES ☐ NO | One | One |
| ☒ YES ☐ NO | Three | Two |

| | | | |
|---|---|---|---|
| 6/30/76 | X YES ☐ NO | ☒ YES ☐ NO | Not any Bidder |

| | | |
|---|---|---|
| ☐ YES ☒ NO | Not Applicable | ☐ YES ☒ NO |
| ☐ YES ☒ NO | ☐ YES ☒ NO | Not Applicable |

Contractor has been in line of work for many years and has established himself as an experienced capable contractor. There is a joint control agreement on payments on this job.

CONTINUATION SHEET ATTACHED ☐ SBA FORM 990 [illegible]

Same type of work $175,000.00

| | | | |
|---|---|---|---|
| $ 175,000.00 | $ 275,000.00 | ☐ YES ☒ NO | ☒ YES ☐ NO |
| ☐ YES ☒ NO | Not Applicable | | |

See Attached Resume

| | | | |
|---|---|---|---|
| ☒ YES ☐ NO | ☒ YES ☐ NO | ☒ YES ☐ NO | ☒ YES ☐ NO |
| ☒ YES ☐ NO | ☒ YES ☐ NO | July 30, 1976 | Alan & Assoc. Inc |
| ☐ YES ☐ NO | ☐ CASH ☐ SIMPLE ACCRUAL ☒ COMPLETED CONTRACT ☐ % COMPLETION | | |
| $ [illegible].67.76 | $50,000.00 | ☒ YES ☐ NO | $ [illegible],000.00 |

SBA Form 990B [illegible]

| | | |
|---|---|---|
| ☒ YES ☐ NO | St. Joseph Bank & Trust Co. | $100,000.00 |

| | | | |
|---|---|---|---|
| ☐ YES ☒ NO | Not Applicable | Not Applicable | Not Applicable |
| ☐ YES ☒ NO | Not Applicable | Not Applicable | Not Applicable |

No problems relative to bill paying.

| | | | |
|---|---|---|---|
| ☐ YES ☒ NO | Not Applicable | PREVIOUS SBA LOAN? ☐ YES ☒ NO | SBA LOAN APPLIC. PENDING? ☐ YES ☐ NO |

| | | |
|---|---|---|
| ☒ YES ☐ NO | AMOUNT $ various | American Fidelity Fire Ins. Co. |

| | | | |
|---|---|---|---|
| ☐ YES ☒ NO | AMOUNT $ Not Applicable | PREVIOUS SBA BOND GUAR.? ☒ YES ☐ NO | AMOUNT & STATUS None in Progress |

In our opinion, the principal appears to have the financial/management/technical abilities necessary to successfully complete this contract, however, we feel this contractor falls below the normal underwriting standards of our company, and we cannot issue bonds to this contractor without the SBA Guarantee.

| | |
|---|---|
| Henry Rothstein<br>Transportation Motorists Association, Inc. | DATE November 8, 1970 |
| 320 S. Wells Street, Chicago, Illinois 60606 | TELEPHONE 312-922-8400 |

SMALL BUSINESS ADMINISTRATION'S REVIEW

| | | | |
|---|---|---|---|
| 0500-54343-05 | REVIEW OF INITIAL BOND? ☒ YES ☐ NO | SUBSEQUENT BOND? ☒ YES ☒ NO | MEETS SIZE STANDARDS? ☒ YES ☐ NO |
| ☒ YES ☐ NO | WHAT TYPE? | ☐ YES ☐ NO | WHAT TYPE? |

(NAME ASSISTANCE)

☐ IS ☐ IS NOT — ☒ DO ☐ DO NOT APPEAR TO BE RESPONSIBLE

☒ IS ☐ ARE NECESSARY AND THE SURETY COMPANY HAS INDICATED THAT IT WILL NOT ISSUE THE BOND(S) WITHOUT THE SBA GUARANTEE.

This is a small experienced minority contractor. He has handled similar projects in the past and appears capable of performing this job. Surety indicates a $100M bank line of credit available which should provide adequate financing. There is also good control on job costs for this project. [illegible] in bank is [illegible].

| | | | |
|---|---|---|---|
| CONTINUATION SHEET ☐ | SBA FORM 990 ☒ | CONTRACTORS CURRENT FINANCIAL STATEMENT ☒ | COPIES OF BONDS ☐ |

SBA IN RECEIPT OF SBA FORM 913 ☒ AND APPROPRIATE SBA FORM 994 FOR THIS CONTRACTOR AND JOB ☐

| | | | |
|---|---|---|---|
| RECOMMENDATION | ☒ | APPROVAL | ☐ DISAPPROVAL |

| | | |
|---|---|---|
| Elizabeth [illegible] | TITLE ED+ | DATE 11-12-76 |
| Christopher Smith | TITLE EDI | DATE 11-15-76 |

TO BE COMPLETED BY PRINCIPAL

TRADE NAME OF PRINCIPAL

Minority Builders, Inc.

PRINCIPAL'S HOME ADDRESS, STREET, CITY AND STATE (Include ZIP)

2152 Taft St.
Gary, Indiana 46404

PRINCIPAL'S BUSINESS ADDRESS STREET, CITY AND STATE (Include COUNTY AND ZIP)

1525 Clark Rd.
Gary, Indiana 46404

PRINCIPAL'S EMPLOYER ID NUMBER

35-1295649

TO BE COMPLETED BY BROKER AGENT (Producer)

NAME OF SURETY

NAME OF BROKER/AGENT (Producer)

Imperial Agents, Ltd.

BROKER AGENT (Producer's) STREET, CITY AND STATE (Include COUNTY AND ZIP)

4747 West Peterson Avenue
Chicago, Illinois 60646

BROKER AGENT (Producer's) TELEPHONE NUMBER (Include Area Code)

312/286-7730

BROKER AGENT (Producer's) EMPLOYER ID NUMBER

36-2824650

1. Applicant hereby states and affirms the following:

a. The annual gross receipts of my business (including affiliates, as set forth in Part 121 of SBA's Rules and Regulations) during the last fiscal year was $ 357,371 , or, as annually averaged over the past 3 fiscal years, was $ 262,050 (to the nearest hundreds). Type of business: ☐ Proprietorship, ☐ Partnership, ☒ Corporation.
Year Business Formed: 1/19/72 Joint Venture ☐ Yes ☒ No

b. A bid, payment or performance bond is required on the following project in order for me to serve as a ☐ primary contractor or ☒ subcontractor thereon.

c. Contractor certifies having attempted (and failed) to obtain the required bonds without the SBA's guarantee; furthermore, the contractor certifies being aware that some sureties charge higher premium rates for bonds than other do, in accordance with premium rate schedules filed in various States.

d. (1) Brief description of this contract work: Concrete Work - Bergen Const. Co
(2) Estimated time required for completion: 6 (months)
(3) Anticipated project start date: mo. 12 day 1 yr. 76 (4) Projected completion date mo. 6 day 1 yr. 77
(5) Project Location: Chgo (6) Name of ☐ obligee or ☒ Prime Contractor: Bergen Cons

e. Approximate value of contract: $ 213,500.00

f. Applicant, in consideration of assistance from the SBA, herewith agrees it will comply with the nondiscrimination requirements of Title 13, Code of Federal Regulations, Part 112 and Part 113.

g. SBA is authorized to request this information under Executive Order 11625. It will be used only for statistical purposes. You are not required to disclose this information. Failure to do so will not affect your application.
(1) Principal is a ☐ Veteran ☐ Vietnam-ERA Veteran or ☒ Non Veteran (Check one)
(2) Principal is a ☒ Male ☐ Female
(3) Principal is a (0) ☒ Black, (1) ☐ Puerto Rican, (2) ☐ American Indian, (3) ☐ Hispanic (Includes Mexican-American, Cuban, Central or South American or others of Spanish Descent), (4) ☐ Asian (Includes persons of Chinese, Japanese, Korean, and Filipino Descent. Also, native Hawaiians, Indonesians, Samoans, Polynesians and Micronesians), (5) ☐ Eskimos and Aleuts, (6) ☐ Undetermined, (7) ☐ Others-including Caucasians.

2. The date, time and place of the bid opening is as follows: (if applicable).
Date 9/20/75 Time 2pm Place Palatine, Illinois

3. I have read the "Contractor's Processing Fee" section (reverse side) and agree to abide by this fee schedule PROVIDED I receive the contract sought and SBA extends its bond guarantee. I also agree to pay the contractor's SBA processing fee to my Agent/Broker in accordance with Paragraph 9 reverse side.

4. I ☒ do not have an SBA Loan. I ☐ had a previous SBA Loan. I ☐ do have an SBA Loan through the SBA Office in ______ with a balance of $ ______ as of (Date) ______ Loan No. ______

5. I ☐ am ☒ am not an SBA 8(a) Qualified Contractor (Approved business plan on file)
This bond application ☐ does ☒ does not pertain to an 8(a) contract

6. I do ☐ or do not ☒ request Management Assistance.
I have ☐ or have not ☒ previously received SBA Management Assistance.

7. I ☒ have ☐ have not received previous SBA bond guarantees, either under this trade name or another.
If under another trade name, specify:
Trade Name: ______
City/State: ______
When? 19 ___ to 19 ___

8. Have you ever defaulted on any previous surety bonds (SBA or other) (either under this contracting concern's trade name or any other concern's of which you have been a principal)? ☐ Yes ☒ No
If "yes", detailed particulars are to be attached to all four (4) copies of this application form. Particulars should include at least the following: (1) Name of Surety; (2) Name of obligee; (3) SBG No. with suffix Number, if applicable (4) Value of Contracts; (5) Date of Default; (6) Status of Default/Claim, i.e., amount of loss to Surety, etc; (7) Contractor's narrative explanation as to reason for default and actions taken to meet the obligations to the Surety under term of the bond(s).

9. Applicant hereby authorizes any agent, broker, surety company or financial institution in possession of credit, financial or work experience information concerning the undersigned applicant and the applicant's business to release the same to SBA, in order that SBA may evaluate the same for the purpose of bond guarantee assistance. Applicant certifies that any information he submits to any agent, broker or surety company for their evaluation as to the bondability of this contractor is correct and accurate to the best of the contractor's knowledge.

10. Any intentionally false statement in this application or willful misrepresentation relative thereto is a violation of federal law which may subject you to criminal and civil prosecution, 18 U.S.C. Sections 287, 371, 1001; 15 U.S.C. Section 645; 31 U.S.C. Section 231, carrying fines up to $10,000 and imprisonment up to five years.

11. Certification: I hereby certify that all information presented herein is complete and accurate to the best of my knowledge. I further agree to notify SBA, in writing, of any fee(s) paid by me or my designee(s) to the Surety and/or it's representatives which are in excess of the fee structure noted in Paragraph 3, above, and specified in Paragraph 9, reverse side. (Attach a separate sheet detailing amount of such excessive fee(s) and purpose thereof).

Signature (Applicant) ______ Date 11 3 /76

Title President

TO BE COMPLETED BY SBA

DATE REC'D. BY SBA __/__/__

BY: (NAME)

SBG NO. ______

SBA FORM 994 (10-74) REP. SOP 50 45 PREVIOUS EDITIONS ARE OBSOLETE
WHITE COPY - SBA REGIONAL OFFICE PINK COPY - SURETY
YELLOW COPY - SBA DISTRICT OFFICE GOLDENROD COPY - PRODUCER (AGENT/BROKER)

SMALL BUSINESS ADMINISTRATION

0500-56343-C15-52

## GUARANTEE AGREEMENT UNDER TITLE IV, PART B, OF THE SMALL BUSINESS INVESTMENT ACT OF 1958, AS AMENDED

This agreement, made and entered into this 10th day of November, 1976

by and between the Small Business Administration, an agency of the United States Government, hereinafter referred as SBA and

American Fidelity Fire Insurance Company & Heritage Insurance Company Of America, hereinafter referred to as Surety,

relative to Minority Builders, Inc, hereinafter referred to as Principal,

who has applied for bonds required for Concrete work for the Far North District Police Station 6464 North Clark Street Chicago, Illinois
(describe project)

For Bergen Construction Company 55 West Wood Street Palatine, Illino

WITNESSETH: That in consideration of the mutual convenants and agreements herein contained, the parties agree as follows:

1. Surety agrees, conditional on the execution of this guarantee by SBA, to become surety on the bid bond and if Principal's bid price is in line with other bidders in Surety's opinion and the contract price does not exceed $500,000, to become surety on performance, payment, maintenance, or any other bonds necessary or incidental to the performance of the above described contract executed on behalf of the Principal. The agreement in this paragraph shall not apply unless all prescribed underwriting conditions are met, nor shall it apply if subsequent or additional information comes to the attention of the Surety of a nature to change its underwriting decision as to the desirability of executing any of the aforementioned bonds.

2. Surety represents that such bond or bonds when executed by it as to terms and conditions will be in accord with those executed by professional sureties for the type of contract for which such bond or bonds are required to be furnished by Principal.

3. Surety affirms that without this SBA guarantee to Surety it will not issue any of said bonds to Principal.

4. SBA hereby agrees to guarantee to Surety 90% of any "loss" Surety may sustain or incur in good faith by reason of its execution of the bid, payment or performance bond contemplated by this Agreement.

5. SBA agrees that the term "loss" as used in this Agreement shall mean any and all liability, damages, court costs, counsel fees, charges and expenses of whatever kind or nature which the Surety shall or may, at any time, sustain or incur by reason, or in consequence, of having executed the bond or bonds herein guaranteed by SBA.

6. The Surety shall be entitled to credit for any and all disbursements, in and about the matters herein contemplated, made by it in good faith under the belief that it is or was liable for the sums and amounts so disbursed, or that it was necessary or expedient to make such disbursement (including efforts to diminish "loss"), whether such liability, necessity or expediency existed or not, and vouchers or other evidence of such disbursement shall be taken as *prima facie* evidence against SBA of the fact and extent of SBA's liability to Surety.

7. SBA agrees that Surety shall be entitled to reimbursement on a calendar quarterly basis under this guarantee for its loss, adjusted pro rata for any payments received by Surety from any other source.

8. Surety agrees that if any suit or claim is brought or instituted against Surety upon said bond or bonds, Surety shall inform SBA of the same within a reasonable time of receipt of the summons and complaint or claim in the Surety's home office. Unless otherwise agreed, Surety shall take charge of all claim matters arising under said bonds; determine the liability and the amount thereof; compromise, settle or defend any claim or suit; and, take such action as it deems necessary to minimize loss.

9. Subsequent to the signing of the contract by the parties obligated thereon and the execution of the bonds guaranteed herein, no act or omission of the Surety in modifying, amending, limiting or extending any instrument executed by the Surety, nor the execution of any consent to the contract or bond(s) herein referred to, shall in anywise affect the liability of SBA hereunder, nor shall SBA be released from this obligation by reason thereof; and it is further agreed that Surety may thereafter alter, change, modify, amend, limit or extend any instrument or may execute renewal thereof, or other and new obligations in its place or in lieu thereof without notice to SBA, and in such case SBA shall be liable to Surety as fully and to the same extent on account of any such altered, changed, modified, amended, limited or extended instrument or such renewals thereof, or other or new obligations in its place or in lieu thereof, as fully as if such instrument were described at length herein.

10. Surety agrees to pay SBA 10% of its bond(s) premium for and in consideration of SBA's agreement to guarantee the bid, payment or performance bond contemplated by this Agreement. It is further agreed by SBA and Surety that Surety will pay SBA an additional like percentage of the additional premiums collected on any increase in contract price and SBA will make a like percentage refund on any premium reductions resulting from a reduction in the contract price. Where SBA or Surety's share of any additional premium increase or decrease is Five Dollars ($5.00) or less, there shall be no adjustment.

IN WITNESS WHEREOF, the parties have caused this Agreement to be executed the day and year first above written.

NOTICE: This Agreement is amended by Amendment
3 to 13 C.F.R. Part 115 (41 F.R. [illegible]),
published April 20, 1976 and effective
April 21, 1976.

| | |
|---|---|
| Heritage Insurance Company Of America | American Fidelity Fire Insurance Co |
| CO-SURETY LIMIT OF LIABILITY<br>$177,000.00 to include co-sureties as their interest may appear. | CO-SURETY LIMIT OF LIABILITY<br>$36,500.00 to include co-sureties as their interest may appear. |
| By Sidney Rothstein | By Sidney Rothstein |
| Sidney Rothstein Attorney In Fact | Sidney Rothstein Attorney In Fact |

SMALL BUSINESS ADMINISTRATION

By ______________________

SURETY BOND OFFICER
11-15-76

---

Amount of Contract $ 213,500.00
Date 10/28/76

Bond Amount: Bid ______________ Performance 213,500.00 Payment ______________
Date ______________
Premium Charged (and % Rate) 2,567.50 + 437.00
Schedule Contract Completion Date ~~April 21, 1977~~

| | |
|---|---|
| TO BE COMPLETED BY PRINCIPAL<br>TRADE NAME OF PRINCIPAL<br>Minority Builders, Inc. | TO BE COMPLETED BY BROKER/AGENT (Producer)<br>NAME OF SURETY |
| PRINCIPAL'S HOME ADDRESS, STREET, CITY AND STATE (Include ZIP)<br>2152 Taft St.<br>Gary, Indiana 46404 | NAME OF BROKER/AGENT (Producer)<br>Imperial Agents, Ltd. |
| PRINCIPAL'S BUSINESS ADDRESS, STREET, CITY AND STATE (Include COUNTY AND ZIP)<br>1525 Clark Rd.<br>Gary, Indiana 46404 | BROKER/AGENT (Producer's) STREET, CITY AND STATE (Include COUNTY AND ZIP)<br>4747 West Peterson Avenue<br>Chicago, Illinois 60646<br>BROKER/AGENT (Producer's) TELEPHONE NUMBER (Include Area Code)<br>312/286-7730 |
| PRINCIPAL'S EMPLOYER ID NUMBER<br>35-1295649 | BROKER/AGENT (Producer's) EMPLOYER ID NUMBER<br>36-2824650 |

1. Applicant hereby states and affirms the following:

   a. The annual gross receipts of my business (including affiliates, as set forth in Part 121 of SBA's Rules and Regulations) during the past fiscal year was $ 367,371, or, as annually averaged over the past 3 fiscal years, was $ 261,030. (to the nearest hundreds). Type of business: ☐ Proprietorship, ☐ Partnership, ☒ Corporation.
   Year Business Formed: 4/19/72 Joint Venture ☐ Yes ☒ No

   b. A bid, payment or performance bond is required on the following project in order for me to serve as a ☐ primary contractor or ☒ subcontractor thereon.

   c. Contractor certifies having attempted (and failed) to obtain the required bonds without the SBA's guarantee; furthermore, the contractor certifies being aware that some sureties charge higher premium rates for bonds than other do, in accordance with premium rate schedules filed in various States.

   d. (1) Brief description of this contract work: Concrete Work - Bergen Const. Co
   (2) Estimated time required for completion: 6 (months)
   (3) Anticipated project start date: mo. 11 day 2 yr. 76 (4) Projected completion date: mo. 4 day 11 yr. 77
   (5) Project Location: Chgo (6) Name of ☐ obligee or ☒ Prime Contractor: Bergen Const

   e. Approximate value of contract: $ 213,500.00

   f. Applicant, in consideration of assistance from the SBA, herewith agrees it will comply with the nondiscrimination requirements of Title 13, Code of Federal Regulations, Part 112 and Part 113.

   g. SBA is authorized to request this information under Executive Order 11625. It will be used only for statistical purposes. You are not required to disclose this information. Failure to do so will not affect your application.
   (1) Principal is a ☐ Veteran ☐ Vietnam-ERA Veteran or ☒ Non Veteran (Check one)
   (2) Principal is a ☒ Male ☐ Female
   (3) Principal is a (0) ☒ Black, (1) ☐ Puerto Rican, (2) ☐ American Indian, (3) ☐ Hispanic (Includes Mexican-American, Cuban, Central or South American or others of Spanish Descent, (4) ☐ Asian (Includes persons of Chinese, Japanese, Korean, and Filipino Descent. Also, native Hawaiians, Indonesians, Samoans, Polynesians and Micronesians, (5) ☐ Eskimos and Aleuts, (6) ☐ Undetermined, (7) ☐ Others-including Caucasians.

2. The date, time and place of the bid opening is as follows: (if applicable):
Date 9/20/76 | Time 2pm | Place Palatine, Illinois

3. I have read the "Contractor's Processing Fee" section (reverse side) and agree to abide by this fee schedule, PROVIDED I receive the contract sought and SBA extends its bond guarantee. I also agree to pay the contractor's SBA's processing fee to my Agent/Broker in accordance with Paragraph 9 reverse side.

4. I ☒ do not have an SBA Loan. I ☐ had a previous SBA Loan. I ☐ do have an SBA Loan through the SBA Office in ______ ______ with a balance of $ ______ as of (Date) ______ Loan No. ______

5. I ☐ am ☒ am not an SBA 8(a) Qualified Contractor (Approved business plan on file)
This bond application ☐ does ☒ does not pertain to an 8(a) contract

6. I do ☐ or do not ☒ request Management Assistance.
I have ☐ or have not ☒ previously received SBA Management Assistance.

7. I ☒ have ☐ have not received previous SBA bond guarantee, either under this trade name or another - If under another trade name, specify:
Trade Name: ______
City/State: ______
When? 19 ___ to 19 ___

8. Have you ever defaulted on any previous surety bonds (SBA or other) (either under this contracting concern's trade name or any other concern's of which you have been a principal)? ☐ Yes ☒ No
If "yes", detailed particulars are to be attached to all four (4) copies of this application form. Particulars should include at least the following: (1) Name of Surety; (2) Name of obligee; (3) SBG No. with suffix Number, if applicable (4) Value of Contracts; (5) Date of Default; (6) Status of Default/Claim, i.e., amount of loss to Surety, etc; (7) Contractor's narrative explanation as to reason for default and actions taken to meet the obligations to the Surety under term of the bond(s).

9. Applicant hereby authorizes any agent, broker, surety company or financial institution in possession of credit, financial or work experience information concerning the undersigned applicant and the applicant's business to release the same to SBA, in order that SBA may evaluate the same for the purpose of bond guarantee assistance. Applicant certifies that any information he submits to any agent, broker or surety company for their evaluation as to the bondability of this contractor is correct and accurate to the best of the contractor's knowledge.

10. Any intentionally false statement in this application or willful misrepresentation relative thereto is a violation of federal law, which may subject you to criminal and civil prosecution, 18 U.S.C. Sections 287, 371, 1001; 15 U.S.C. Section 645; 31 U.S.C. Section 231, carrying fines up to $10,000 and imprisonment up to five years.

11. Certification: I hereby certify that all information presented herein is complete and accurate to the best of my knowledge. I further agree to notify SBA, in writing, of any fee(s) paid by me or my designee(s) to the Surety and/or it's representatives which are in excess of the fee structure noted in Paragraph 3, above, and specified in Paragraph 9, reverse side. (Attach a separate sheet, detailing amount of such excessive fee(s) and purpose thereof).

Signature (Applicant) Dock Miller Date 11/3/76

Title: President

TO BE COMPLETED BY SBA
DATE REC'D. BY SBA / /
BY: (NAME)
SBG NO.

SBA FORM 994 (10-76) REF: SOP 50 45 PREVIOUS EDITIONS ARE OBSOLETE
WHITE COPY - SBA REGIONAL OFFICE PINK COPY - SURETY
YELLOW COPY - SBA DISTRICT OFFICE GOLDENROD COPY - PRODUCER (AGENT, BROKER)

③ Bond No SBA 7990
2553877

# PERFORMANCE BOND

Approved by The American Institute of Architects,
A.I.A. Document No. A-311 (Sept. 1963 Ed.)

KNOW ALL MEN BY THESE PRESENTS:

That Minority Builders, Inc
(Here insert the name and address or legal title of the Contractor)
1525 Clark Road Gary, Indiana 46404
as Principal, hereinafter called Contractor, and American Fidelity Fire Insurance Company & Heritage Insurance Company Of America as Surety,
hereinafter called Surety, are held and firmly bound unto Bergen Construction Corporation
(Here insert the name and address or legal title of the Owner)
55 West Wood Street Palatine, Illinois 60067
as Obligee, hereinafter called Owner, in the amount of
Two hundred thirteen thousand five hundred & 00/100 Dollars ($ 213,500.00 ),
for the payment whereof Contractor and Surety bind themselves, their heirs, executors, administrators, successors and assigns, jointly and severally, firmly by these presents.

WHEREAS, Contractor has by written agreement dated October 27, 1976
entered into a contract with Owner for Concrete work for the far North District Police Stati at 6464 North Clark Street Chicago, Illinois 60626
in accordance with drawings and specifications prepared by
(Here insert full name, title and address)

which contract is by reference made a part hereof, and is hereinafter referred to as the Contract.

NOW, THEREFORE, THE CONDITION OF THIS OBLIGATION is such that, if Contractor shall promptly and faithfully perform said contract, then this obligation shall be null and void; otherwise it shall remain in full force and effect.

The Surety hereby waives notice of any alteration or extension of time made by the Owner.

Whenever Contractor shall be, and declared by Owner to be in default under the Contract, the Owner having performed Owner's obligations thereunder, the Surety may promptly remedy the default, or shall promptly

1) Complete the Contract in accordance with its terms and conditions, or

2) Obtain a bid or bids for submission to Owner for completing the Contract in accordance with its terms and conditions, and upon determination by Owner and Surety of the lowest responsible bidder, arrange for a contract between such bidder and Owner, and make available as work progresses (even though there should be a default or a succession of defaults under the contract or contracts of completion arranged under this paragraph) sufficient funds to pay the cost of completion less the balance of the contract price; but not exceeding, including other costs and damages for which the Surety may be liable hereunder, the amount set forth in the first paragraph hereof. The term "balance of the contract price," as used in this paragraph, shall mean the total amount payable by Owner to Contractor under the Contract and any amendments thereto, less the amount properly paid by Owner to Contractor.

Any suit under this bond must be instituted before the expiration of two (2) years from the date on which final payment under the contract falls due.

No right of action shall accrue on this bond to or for the use of any person or corporation other than the Owner named herein or the heirs, executors, administrators or successors of Owner.

Signed and sealed this 16th day of November A.D. 19 76.

In the presence of:

Minority Builders, Inc (Seal)
(Principal)

(Title)

ritage Insurance Company Of America
SURETY LIMIT OF LIABILITY
77,000.00 to include co-sureties
their interest may appear.

American Fidelity Fire Insurance Co (Seal)
CO-SURETY LIMIT OF LIABILITY
$ 36,500.00 to include co-sureties
as their interest may appear.

# HE[illegible]E INSURANCE COMPANY OF A[illegible]ICA

LINCOLNWOOD, ILLINOIS

## Power of Attorney

PRINCIPAL Minority Builders, Inc
Gary, Indiana 46404
0500-56343-015-52

EFFECTIVE DATE 11/16/76
AMOUNT OF BOND $ 177,000.00
POWER NO. 2.SBA Nº 7990

KNOW ALL MEN BY THESE PRESENTS: That the Heritage Insurance Company, a Corporation in the State of Illinois, having its principal office in Lincolnwood, Illinois, pursuant to the following resolution, adopted by the Board of Directors of the said Company on the 14th day of November, 1973, to wit:

"The President, or any Vice-President, or other officer designated by the Board of Executive Committee shall have authority, severally, to make execute and deliver a power of attorney constituting as Attorney-in-Fact such persons, firms or corporations as such officers may select from time to time."

does hereby make, constitute and appoint Martin L. Shape, Martin L. Schwartz and/or Sidney Rothstein of Chicago, in the State of Illinois, its true and lawful attorney(s)-in-fact, with full power and authority hereby conferred in its name, place and stead, to sign, execute, acknowledge and deliver in its behalf, and its act and deed, as follows:

Specifically and only on bonds executed having 90% indemnification of small business administration, bonds not exceeding two hundred twenty thousand ($220,000.00) dollars.

and to bind Heritage Insurance Company thereby as fully and to the same extent as if such bond or undertaking was signed by the duly authorized officers of the Heritage Insurance Company, and all the acts of said Attorney(s) pursuant to the authority herein given, are hereby ratified and confirmed.

IN WITNESS WHEREOF, the Heritage Insurance Company has caused these presents to be signed by its President and/or its Vice-President, and its Corporate Seal to be hereto affixed.

HERITAGE INSURANCE COMPANY OF AMERICA

Vincent M Giacinto
Vincent M. Giacinto, President

State of Illinois }
County of Cook } SS:

On this 14th day of November, 1973, before the subscriber, a Notary Public of the State of Illinois in and for the County of Cook duly commissioned and qualified, came V. M. Giacinto of the Heritage Insurance Company, to me personally known to be the individual and officer described herein, and who executed the preceding instrument, and acknowledged the execution of the same, and being by me duly sworn, deposed and said, that he is the officer of said Company aforesaid, and that the seal affixed to the preceding instrument is the Corporate Seal of said Company, and the said Corporate Seal and signature as an officer were duly affixed and subscribed to the said instrument by the authority and direction of the said Corporation, and that the resolution of said Company, referred to in the preceding instrument, is now in force.

IN TESTIMONY WHEREOF, I have hereunto set my hand, and affixed my official seal at Lincolnwood, Illinois, the day and year above written.

Joseph D. Udoni
Notary Public

JOSEPH D. UDONI
NOTARY PUBLIC, State of Illinois
Qualified in State of Illinois
Commission Expires March 4, 1976

State of Illinois }
County of Cook } SS:

### CERTIFICATE

I, the undersigned, Secretary of HERITAGE INSURANCE CO. a stock corporation of the State of Illinois, DO HEREBY CERTIFY that the foregoing and attached Power of Attorney and Certificate of Authority remains in full force and has not been revoked; and furthermore, that the Resolution of the Board of Directors, as set forth in the Certificate of Authority, are now in force.

Signed and Sealed at the Home Office of the Company, at Lincolnwood, Illinois. Dated this 16th day of November A.D., 19 76

George B. Silverman
Secretary

AMERICAN FIDELITY FIRE INSURANCE COMPANY
WOODBURY, NEW YORK

## POWER OF ATTORNEY

KNOW ALL MEN BY THESE PRESENTS: That the American Fidelity Fire Insurance Company, a Corporation in the State of New York, having its principal office in Woodbury, State of New York, pursuant to the following resolution, adopted by the Board of Directors of the said Company on the 18th day of February, 1969, to wit:

"The President, or any Vice-President, or other officer designated by the Board Executive Committee shall have authority, severally, to make execute and deliver a power of attorney constituting as Attorney-in-Fact such persons, firms or corporations as such officers may select from time to time," does hereby make, constitute and appoint

**MARTIN L. SHAPE and/or BURTON HARRIS and/or SIDNEY ROTHSTEIN of CHICAGO, ILLINOIS**

its true and lawful attorney(s)-in-fact, with full power and authority hereby conferred in its name, place and stead, to sign, execute, acknowledge and deliver in its behalf, and as its act and deed, as follows:

Specifically and only on bonds executed having 90% indemnification of the Small Business Administration in an amount not exceeding $300,000.00 as to any one project, for or on behalf of this Company, in its business and in accordance with its charter, and to bind American Fidelity Fire Insurance Company thereby, and all of the acts of said Attorney-in-Fact, pursuant to these presents, are hereby ratified and confirmed.

IN WITNESS WHEREOF, the American Fidelity Fire Insurance Company has caused these presents to be signed by its President and/or Vice-President, and its Corporate Seal to be hereto affixed.

AMERICAN FIDELITY FIRE INSURANCE COMPANY

Robert J Kennedy

Robert J. Kennedy, Vice-President

State of New York }
County of Nassau } ss.

On this 1st day of July, 1976, before the subscriber, a Notary Public of the State of New York in and for the County of Nassau duly commissioned and qualified, came Robert J. Kennedy of the American Fidelity Fire Insurance Co., to me personally known to be the individual and officer described herein, and who executed the preceding instrument, and acknowledged the execution of the same, and being by me duly sworn, deposed and said, that he is the officer of said Company aforesaid, and that the seal affixed to the preceding instrument is the Corporate Seal of said Company, and the said Corporate Seal and signature as an officer were duly affixed and subscribed to the said instrument by the authority and direction of the said Corporation, and that the resolution of said Company, referred to in the preceding instrument, is now in force.

IN TESTIMONY WHEREOF, I have hereunto set my hand, and affixed my official seal at Woodbury, New York the day and year above written.

Elizabeth M Roselle

Notary Public

ELIZABETH M. ROSELLE
NOTARY PUBLIC, State of New York
No. 30-8643115
Qualified in Nassau County
Commission Expires March 30, 1978

State of New York }
County of Nassau } ss.

## CERTIFICATE

I, the undersigned, Assistant Secretary of AMERICAN FIDELITY FIRE INSURANCE COMPANY a stock corporation of the State of New York, DO HEREBY CERTIFY that the foregoing and attached Power of Attorney and Certificate of Authority remains in full force and has not been revoked; and furthermore, that the Resolution of the Board of Directors, as set forth in the Certificate of Authority, are now in force.

Signed and Sealed at the said Company, at Woodbury, New York, dated this 16 day of November, 19 76

Harold L. Rosenthal

Assistant Secretary

IL S/H/R 300 (7/6)

SMALL BUSINESS ADMINISTRATION

## GUARANTEE AGREEMENT UNDER TITLE IV, PART B, OF THE SMALL BUSINESS INVESTMENT ACT OF 1958, AS AMENDED

This agreement, made and entered into this 10th day of November, 19 76,

by and between the Small Business Administration, an agency of the United States Government, hereinafter referred as SBA and

American Fidelity Fire Insurance Company & Heritage Insurance Company Of America, hereinafter referred to as Surety,

relative to Minority Builders, Inc, hereinafter referred to as Principal,

who has applied for bonds required for Concrete work for the Far North District Police Station 6464 North Clark Street Chicago, Illinois
(describe project)
For Bergen Construction Company 55 West Wood Street Palatine, Illinois

WITNESSETH: That in consideration of the mutual convenants and agreements herein contained, the parties agree as follows:

1. Surety agrees, conditional on the execution of this guarantee by SBA, to become surety on the bid bond and if Principal's bid price is in line with other bidders in Surety's opinion and the contract price does not exceed $500,000, to become surety on performance, payment, maintenance, or any other bonds necessary or incidental to the performance of the above described contract executed on behalf of the Principal. The agreement in this paragraph shall not apply unless all prescribed underwriting conditions are met, nor shall it apply if subsequent or additional information comes to the attention of the Surety of a nature to change its underwriting decision as to the desirability of executing any of the aforementioned bonds.

2. Surety represents that such bond or bonds when executed by it as to terms and conditions will be in accord with those executed by professional sureties for the type of contract for which such bond or bonds are required to be furnished by Principal.

3. Surety affirms that without this SBA guarantee to Surety it will not issue any of said bonds to Principal.

4. SBA hereby agrees to guarantee to Surety 90% of any "loss" Surety may sustain or incur in good faith by reason of its execution of the bid, payment or performance bond contemplated by this Agreement.

5. SBA agrees that the term "loss" as used in this Agreement shall mean any and all liability, damages, court costs, counsel fees, charges and expenses of whatever kind or nature which the Surety shall or may, at any time, sustain or incur by reason, or in consequence, of having executed the bond or bonds herein guaranteed by SBA.

6. The Surety shall be entitled to credit for any and all disbursements, in and about the matters herein contemplated, made by it in good faith under the belief that it is or was liable for the sums and amounts so disbursed, or that it was necessary or expedient to make such disbursement (including efforts to diminish "loss"), whether such liability, necessity or expediency existed or not, and vouchers or other evidence of such disbursement shall be taken as prima facie evidence against SBA of the fact and extent of SBA's liability to Surety.

7. SBA agrees that Surety shall be entitled to reimbursement on a calendar quarterly basis under this guarantee for its loss, adjusted pro rata for any payments received by Surety from any other source.

8. Surety agrees that if any suit or claim is brought or instituted against Surety upon said bond or bonds, Surety shall inform SBA of the same within a reasonable time of receipt of the summons and complaint or claim in the Surety's home office. Unless otherwise agreed, Surety shall take charge of all claim matters arising under said bonds: determine its liability and the amount thereof, compromise, settle or defend any claim or suit; and, take such action as it deems necessary to minimize loss.

9. Subsequent to the signing of the contract by the parties obligated thereon and the execution of the bonds guaranteed herein, no act or omission of the Surety in modifying, amending, limiting or extending any instrument executed by the Surety, nor the execution of any consent to the contract or bond(s) herein referred to, shall in anywise affect the liability of SBA hereunder, nor shall SBA be released from this obligation by reason thereof; and it is further agreed that Surety may thereafter alter, change, modify, amend, limit or extend any instrument or may execute renewal thereof, or other and new obligations in its place or in lieu thereof without notice to SBA, and in such case SBA shall be liable to Surety as fully and to the same extent on account of any such altered, changed, modified, amended, limited or extended instrument or such renewals thereof, or other or new obligations in its place or in lieu thereof, as fully as if such instrument were described at length herein.

10. Surety agrees to pay SBA 10% of its bond(s) premium for and in consideration of SBA's agreement to guarantee the bid, payment or performance bond contemplated by this Agreement. It is further agreed by SBA and Surety that Surety will pay SBA an additional like percentage of the additional premiums collected on any increase in contract price and SBA will make a like percentage refund on any premium reductions resulting from a reduction in the contract price. Where SBA or Surety's share of any additional premium increase or decrease is Five Dollars ($5.00) or less, there shall be no adjustment.

IN WITNESS WHEREOF, the parties have caused this Agreement to be executed the date and year first above written.

Heritage Insurance Company Of America
CO-SURETY LIMIT OF LIABILITY
$177,000.00 to include co-sureties
as their interest may appear.
By ______________________
Sidney Rothstein Attorney In Fact

American Fidelity Fire Insurance Co
CO- SURETY LIMIT OF LIABILITY
$36,500.00 to include co-sureties
as their interest may appear.
By ______________________
Sidney Rothstein Attorney In Fact

SMALL BUSINESS ADMINISTRATION

By ______________________

---

Amount of Contract $ 213,500.00
Date 10/28/76

Bond Amount: Bid ____________ Performance 213,500.00 Payment ____________
Date ____________
Premium Charged (and % Rate) 2,567.50 + 437.00
Scheduled Contract Completion Date April 11, 1977

western union Mailgram

2-035353E253002 09/10/77 ICS IPMBNGZ CSP CGAB
1 MGM TDBN LINCOLNWOOD IL 09-10 0354P EST

⑤

DICK & THOMAS
7366 NORTH LINCOLN AVE
LINCOLNWOOD IL 60646

THIS MAILGRAM IS A CONFIRMATION COPY OF THE FOLLOWING MESSAGE:

MGM TDBN LINCOLNWOOD IL 243 09-10 0242P EST
7IP
MINORITY BUILDERS INC
1525 CLARK RD
GARY IN 46404

HAVE RECEIVED NOTIFICATION FROM MINORITY BUILDERS INC ADMITTING INABILITY AND NON-DESIRE TO COMPLETE PROJECT COMMONLY KNOWN AS THE CHICAGO POLICE DEPARTMENT BUILDING LOCATED AT OR NEAR CLARK AND DEVON STREETS CHICAGO ILLINOIS. I HAVE FURTHER BEEN ADVISED BY THE OFFICERS OF MINORITY THAT THE EXPECTED LOSS FOR COMPLETION OF THIS PROJECT WILL BE IN EXCESS OF $40,000.

ON SEPTEMBER 9 1977 THIS OFFICE IN A TELEPHONE CONVERSATION WITH MR MILLER, PRESIDENT OF MINORITY BUILDERS, WAS ADVISED THAT WORK HAD BEEN VOLUNTARILY DISCONTINUED AND THAT IT WAS INTENDED THAT WORK WOULD NOT BE RESUMED. THIS CONVERSATION FOLLOWED NOTIFICATON FROM MR BERGMAN THAT MR MILLER HAD ADVISED THAT MINORITY BUILDERS INC WOULD BE TERMINATING THEIR BUSINESS OPERATIONS.

THE ABOVE INFORMATION IS CONVEYED TO YOU AT THIS TIME PURSUANT TO YOUR RIGHTS UNDER GENERAL AGREEMENT OF INDEMNITY EXECUTED BY YOURSELF PERSONALLY AT THE TIME THAT MINORITY BUILDERS PROCURED THEIR BOND.

IT IS OUR INTENT ON BEHALF OF HERITAGE INSURANCE CO OF AMERICA AND AMERICAN FIDELITY FIRE INSURANCE CO OF NEW YORK TO TAKE SUCH STEPS AS ARE NECESSARY TO PROTECT THE INTEREST OF THESE COMPANIES AND INDIRECTLY YOUR OWN INTEREST. I THEREFORE PROPOSE TO IMMEDIATELY PROCURE COMPLETION CONTRACTOR AND TO CAUSE COMPLETION OF THE PROJECT AND PAYMENT OF OBLIGATIONS. UNLESS INSTRUCTED BY YOU TO THE CONTRARY WE SHALL PROCEED WITH THIS ACTION NO LATER THAN TUESDAY OF NEXT WEEK. A COPY OF THIS MAILGRAM IS BEING SENT TO MR JOHN J LOWREY ATTORNEY FOR MINORITY BUILDERS.

MELVIN DICK
DICK & THOMAS
ATTORNEYS
7366 NORTH LINCOLN AVE
LINCOLNWOOD IL 60646

LAW OFFICES
DICK & THOMAS
SUITE 202
7366 NORTH LINCOLN AVENUE
LINCOLNWOOD, ILLINOIS 60646

MELVIN S. DICK
GEORGE W. THOMAS
BRUCE L. HAAS

TELEPHONE
(312) 982-9333

⑥

October 6, 1977

Heritage Insurance Company
7366 N. Lincoln Avenue
Lincolnwood, Illinois 60646

Re: Principal: Minority Builders, Inc.
Obligee: Bergen Construction Company Corp.
Carrier: Heritage Insurance/American Fidelity
Bond No.: SBA 7990/04-746-2553877
SBG No.: 0500-56343-0-15-52
Our File: C-370

Gentlemen:

I wish to apologize for the delay in the processing of this report which is quite frankly occasioned by the necessity of my absence from the office on an extended trial for the past two weeks.

Subsequent to my most recent reports Minority Builders was notified of potential default on this claim by the obligee. The default notice provided that if work was not recommenced in a vastly improved manner within seven days, that formal and technical default would exist.

At this time I was notified by the attorney for our principal that in fact Minority Builders had abandoned the project and was unable to complete same. As indicated in my prior reports it appeared that our contractor was short substantial sums of money for completion and payment of claims which eventually evolved to be an amount well in excess of $100,000.00.

The project in question is the construction of a Chicago Police Department Center and the work to be performed by our Principal was and is the provision of the concrete work required under the initial plans and specifications.

In review of this matter with Mr. Regis Morganti, architect, he advised that unless immediate actions were taken to complete before cold weather arrived there could in fact result extremely substantial difficulties.

Discussion with Mr. Miller produced the following information:

a. The original project bid was approximately $435,000.00. His bid was approximately $20,000.00 less than that of International Concrete.

b. Subsequent thereto, extensive negotiations followed with resulting omissions on extended work, verbally, and eventual reduction of the contract price to the bonded amount.

The contractor was then presented a written contract which he executed.

I then contracted International Concrete who verified the above but indicated that in addition to the items as excluded per the written contract he had in his negotiations which approached the $230,000.00 figure omitted the following items:

a. No insulation concrete estimated value $35,000.00 plus.

b. No membrane water proofing.

c. No joint sealings.

d. No testing.

e. No apoxie floors.

Mr. Miller was asked about these matters and indicated that apparently they were included in his written contract and he had "missed them by".

International was asked to bid on the project for completion as time was of the essence and indicated that they refused and would not touch this project for any price.
As time was rapidly passing the following bidds were procured by telephone:

| | | |
|---|---|---|
| 1. | Midwest Concrete | $204,000.00 |
| 2. | J. D. Concrete | 202,000.00 |
| 3. | K-Concrete | 210,000.00 |
| 4. | State Construction | 196,000.00 |

After review thereof the contract was executed with State Construction and I am pleased to state that the work is moving at an extremely smooth and expediated state.

Difficulties however rapdily developed regarding Bergen which have culminated in the attached letter. There is approximately $100,000.00 of funds in contract and I have advised Bergen that unless an accounting is received immediately Surety will have no alternative but to take appropriate legal action and I have been assured that the figures will arrive in the immediate future.

I have also received notice of unpaid claims from Material Services of approximately $22,000.00 and several other creditors have indicated to the Obligee that they are forwarding additional statements to this office. It is estimated that the unpaid bills will approximate $40,000.00.

Assuming therefore, (subject to book charges, etc. by the obligee) that there are in fact $100,000.00 in contract funds, the loss at this moment is approximated at $140,000.00.

I am therefore requesting a reserve be established in the sum of $145,000.00 as it is essential that both architects and engineers be involved in relation to the matters contained in my letter of this date to Mr. Bergen.

Upon receipt and verification of all necessary claim figures, I shall immediately adjust the reserves accordingly.

Very truly yours,

Melvin S. Dick

MSD:df
Enclosures

cc: SBA - Chicago, Washington
    MIC

WAIVER OF LIEN–PARTIAL
Materials or Labor

*State of Illinois* } *ss*
*Cook County*

*Whereas,* the undersigned, Material Service Corporation has been employed by Concrete Structures and State Construction Company

to furnish Ready Mix Concrete

for the building known as Police Station - 6464 N. Clark Street Avenue Street

City of Chicago County of Cook, State of Illinois.

*Now, Therefore, know ye,* that Material Service Corporation, the undersigned, being requested to give a partial waiver to the extent of this payment, for and in consideration of the sum of 34,075.60 Dollars, the receipt whereof is hereby acknowledged, does hereby waive and release to the extent of the said amount only any and all lien, or claim, or right to lien on said above described building and premises under the Statutes of the State of Illinois relating to Mechanics' Liens, on account of labor or materials, or both, furnished to the extent of this payment only, for said building or premises.

*Given* under our hand and seal this 29th day of September A.D. 19 77

(F 434)gm

Material Service Corporation

(Seal)

By (Seal)
ITS DULY AUTHORIZED AGENT

This waiver invalid if altered in any manner.

350yys
P-A

---

WAIVER OF LIEN–PARTIAL
Materials or Labor

*State of Illinois* } *ss*
*Cook County*

*Whereas,* the undersigned, Material Service Corporation has been employed by Concrete Structures and Statr Construction Company

to furnish Ready Mix Concrete

for the building known as Chgo. Police Station 6464 North Clark Avenue Street

City of Chicago County of Cook, State of Illinois.

*Now, Therefore, know ye,* that Material Service

WAIVER OF LIEN–PARTIAL

Materials or Labor

*State of Illinois*
} *ss*
*Cook County*

*Whereas,* the undersigned, Material Service Corporation has been employed by Concrete Structures and State Construction Company

to furnish Ready Mix Concrete

for the building known as Chgo. Police Station 6464 North Clark Avenue Street

City of Chicago County of Cook, State of Illinois.

*Now, Therefore, know ye,* that Material Service Corporation, the undersigned, being requested to give a partial waiver to the extent of this payment, for and in consideration of the sum of $17,603.00 Dollars, the receipt whereof is hereby acknowledged, does hereby waive and release to the extent of the said amount only any and all lien, or claim, or right to lien on said above described building and premises under the Statutes of the State of Illinois relating to Mechanics' Liens, on account of labor or materials, or both, furnished to the extent of this payment only, for said building or premises.

*Given* under our hand and seal this 30th day of December A.D. 1977

Material Service Corporation

In Quintuplicate (G 468)gm (Seal)

This waiver invalid if altered in any manner. By (Seal)

ITS DULY AUTHORIZED AGENT

350yys
P-A

**WAIVER OF LIEN–FINAL**
**Materials or Labor**

*State of Illinois*
*Cook County* } ss

*To all Whom it may Concern:*

*Whereas,* the undersigned, Material Service Corporation has been employed by Concrete Structures and State Construction to furnish Ready Mix Concrete

for the building known as Chicago Police Station-6464 North Clark Street Avenue Street
City of Chicago County of Cook, State of Illinois.

*Now, Therefore, know ye,* that Material Service Corporation, the undersigned for and in consideration of the sum of $7,388.00 Dollars, and other good and valuable consideration, the receipt whereof is hereby acknowledged, does hereby waive and release any and all lien, or claim or right of lien on said above described building and premises under the Statutes of the State of Illinois relating to Mechanics' Liens, on account of labor or materials, or both, furnished, or which may be furnished, by the undersigned to or on account of the said Concrete Structures for said ready mix concrete

for said building or premises.

*Given* under our hand and seal this 30th day of April A.D. 19 78.

In Quadruplicate (H 377)

Material Service Corporation (Seal)

By (Seal)
ITS DULY AUTHORIZED AGENT

This waiver invalid if altered in any manner.
349-yvs

370 ⑧

## PAY OUT ORDER

Heritage Insurance Company Date May 25, 1978
(Name of paying agent)

| | |
|---|---|
| Statement of Account | |
| Contract Price | $ 196,000.00 |
| Extras | $ 1,200.00 |
| Deduct Credit | $ -------- |
| Previously Paid | $ 159,128.00 |
| Balance | $ 38,072.00 |
| This Payment | $ 38,072.00 |
| Balance to Become Due | $ -------- |

Address of Property 6464 N. Clark Street, Chicago

Amount $38,072.00

In favor of State Construction Company
2810 S. Ellis Avenue
Elk Grove, Illinois 60007

For concrete work to complete contract for the Far North Police Station

This is to certify that State Construction

is entitled to a payment of $38,072.00 on account of the contract and work described above.

Contractor State Construction Company

Owner's approval

Inspector or Architect

## FINAL WAIVER OF LIEN

STATE OF ILLINOIS }
COUNTY OF } ss.

TO WHOM IT MAY CONCERN:

Whereas, the undersigned State Construction Company has been employed by Heritage Insurance Company to furnish material and labor for the concrete work at the premises commonly known as 6464 N. Clark Street Chicago, Illinois

The undersigned, for and in consideration of Thirty eight thousand seventy two dollars ($38,072.00) Dollars, and other good and valuable considerations, the receipt whereof is hereby acknowledged, does hereby waive and release any and all lien or claim or right of lien under the Statutes of Illinois relating to Mechanic's liens, on the above described premises and improvements thereon and on the monies or other considerations due or become due from the owner on account of labor or services, material, fixtures, apparatus or machinery heretofore furnished or which may be furnished at any time hereafter by the undersigned for the above described premises.

Dated this 25th day of May, 19 78
[Affix corporate seal here.]

(signature of secretary of corporation)

signature of sole owner or authorized representative of corporation or partnership

All waivers must state the actual amount paid and the affidavit on the reverse side hereof must be completely filled out, signed and sworn to before a Notary Public.
Waivers from all material men and sub-contractors (labor and material) must be furnished.

CONTRACTOR'S AFFIDAVIT ON REVERSE MUST BE FILLED IN, SIGNED AND NOTARIZED

FNTI

# CONTRACTOR'S AFFIDAVIT

STATE OF ILLINOIS }
COUNTY OF } ss.

TO WHOM IT MAY CONCERN:

The undersigned, first being duly sworn, deposes and says that he is Sole owner of the
(Sole Owner, Partner, or Officer)
State Construction Company the contractor employed by
(Firm Name)
Heritage Insurance Company for the concrete work on building(s)
located at 6464 N. Clark Street Chicago, IL and owned by

That the total amount of the contract is $197,200.00 on which he has received payment of $159,128.00 that the following statement includes: The names of all parties who have furnished or who have been contracted with by affiant to furnish material or labor for said improvement and the amounts furnished by, contracted for, paid or due and to become due each; and that the items mentioned include all labor and material required to complete said work according to plans and specifications:

| Names and Addresses | What For | Contract Price | Amount Paid | Balance Due |
|---|---|---|---|---|
| State Construction Company | concrete work | $197,200.00 | $159,128.00 | $38,072.00 |
| Material Services Corp. | Ready Mix concrete | $ 7,388.00 | $ 7,388.00 | $00,000.00 |
| | | | | |
| | | | | |
| | | | | |
| Total Labor and Material to Complete | | | | |

All material (except as above listed) has been or will be furnished from my (our) own stock and has been paid for in full.

The undersigned further states that there are no other contracts for said work outstanding, and that there is nothing due or to become due to any person for material labor or other work of any kind done or to be done upon or in connection with said work other than above stated; That all waivers are true, correct, and genuine and delivered unconditionally and that there is no claim either legal or equitable to defeat the validity of said waivers.

Subscribed and sworn to before me this 25th day of May A.D. 19 78

Notary Public

MUST BE NOTARIZED

Sign only: Name of the individual, who is the affiant making this affidavit. This affidavit accepted ONLY when signed by: sole owner, co-partner, or an officer of a Corporation.

⑨

370

Minority BLDERS

**STATE CONSTRUCTION COMPANY**
SUBSIDIARY OF STATE TRANSPORT, INC.
2810 SO. ELLIS AVENUE
ELK GROVE, IL 60007
595-4421 595-4889

September 9, 1977

Melvin S. Dick
7366 North Lincoln Avenue
Lincolnwood, Illinois 60646

RE: Far North Police Station
6446 North Clark Street
Chicago, Illinois

Dear Mr. Dick:

We have inspected the above site. reviewed all plans and specifications and are hereby submitting a bid in the amount of $ 196,000.00 [ One Hundred Ninty-Six Thousand and No/100-----------Dollars ]

In the event this bid is agreeable to you, we would appreciate the opportunity of starting work on this project as soon as possible as we feel weather is all important and winter will soon be upon us.

Thanking you for the opportunity of bidding this work, we remain

Very truly yours,

Anthony Giacomino, President
STATE CONSTRUCTION COMPANY

AG/dg

DiGioia Brothers Construction Co.
21 W 225 Par Lane
Itasca, Illinois 60143
773-0768

370

September 19, 1977

Melvin S. Dick
7366 North Lincoln Avenue
Lincolnwood, Illinois 60646

Dear Mr. Dick:

As per our telephone conversation regarding the Northside Chicago Police Station, 6446 North Clark Street, Chicago, Illinois, after inspection of all concrete work for the afforementioned project, according to plans and specifications, we hereby submit the following lump sum to complete said project:

$ 204,000.00

Please Contact this office at your earliest convenience, if this price is agreeable with you, so that we may proceed with this work as weather will be playing an important role in completion dates' on this project.

Sincerely,

DI GIOIA BROTHERS CONSTRUCTION CO.
INC.

VDG/mw

Vito Di Gioia, President

VIKING Concrete Construction Inc.
15448-A S. Wentworth Ave. • South Holland, IL. 60473 • (312) 339-0005

370

September 6, 1977

Melvin Dick
7366 North Lincoln
Lincolnwood, Illinois

Gentlemen

Our bid for the concrete work at the far North Police Station, 6400 Clark, Chicago, Illinois is $ 202,000.00.

We have looked at the plans and Specifications.

Hoping to hear from you in the near future

George Thorpe
George Thorpe, VPres.
Viking Concrete Const. Inc.

GT/////

P&M CONSTRUCTION CO.
XXXXXXXXXXXXXXXXXXXXX Sixth Ave. & Lake St.
ADDISON, ILLINOIS 60101

CEMENT CONTRACTORS

(312) 543-4771

September 12,1977

Melvin S. Dick
7366 N. Lincoln Street
Lincolnwood, Il

This proposal is in regards to all concrete work that has to be done to complete concrete contract, on the far north district police station. located at 6464 N. Clark Street, our work will be completed according to specifications, for the amount of Two Hundred Ten Thousand Dollars.

P & M Construction Co.
Pat Selvaggio-Vice Pres.

PS/ci

**HERITAGE INSURANCE COMPANY OF AMERICA**
7366 NORTH LINCOLN AVE. LINCOLNWOOD, ILLINOIS 60646 312-463-2000

⑩

NO H 42545
70-2255
719

DATE October 17th, 19 77

PAY TO THE ORDER OF State Construction Company. $91,728.00

PAID OCT 26 1977

[illegible] 91728 [illegible] DOLLARS

CL. NO. 12HB-0108 IN PAYMENT OF LOSS WHICH OCCURRED AT ABOUT 19

POLICY NUMBER INSURED NAME & ADDRESS Minority Builders, Inc. Bond No. SBA-7990/04

Payable through
BANK OF LINCOLNWOOD
4433 W. TOUHY AVE.
70-2255 LINCOLNWOOD, ILLINOIS 70-2255

| SFX | COV | TYPE | AMT |
|---|---|---|---|
| 1. | 11 | P | $91,728.00 |
| | | | $ |

drf

THIS DRAFT VOID AFTER 90 DAYS
HERITAGE INSURANCE COMPANY OF AMERICA
CLAIM ACCOUNT

Joseph N Morreale

⑆0719⑉2255⑆ 09⑉9902 4⑈ ⑈0009172800⑈

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**HERITAGE INSURANCE COMPANY OF AMERICA**
7366 NORTH LINCOLN AVE. LINCOLNWOOD, ILLINOIS 60646 312-463-2000

NO H 43428
70-2255
719

DATE November 10th, 19 77

PAY TO THE ORDER OF State Construction Company. $42,400.00

[illegible] 424 [illegible] DOLLARS

CL. NO. 12HB-0108 IN PAYMENT OF LOSS WHICH OCCURRED AT ABOUT 19

POLICY NUMBER INSURED NAME & ADDRESS Minority Builders, Inc. Bond No. SBA-7990

Payable through
BANK OF LINCOLNWOOD
4433 W. TOUHY AVE.
70-2255 LINCOLNWOOD, ILLINOIS 70-2255

| SFX | COV | TYPE | AMT |
|---|---|---|---|
| 1. | 11 | P | $42,400.00 |
| | | | $ |

drf

THIS DRAFT VOID AFTER 90 DAYS
HERITAGE INSURANCE COMPANY OF AMERICA
CLAIM ACCOUNT

Joseph N Morreale

⑆0719⑉2255⑆ 09⑉9902 4⑈ ⑈0004240000⑈

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**HERITAGE INSURANCE COMPANY OF AMERICA**
7366 NORTH LINCOLN AVE. LINCOLNWOOD, ILLINOIS 60646

NO H 47809
70-2255
719

DATE March 31st, 19 78

PAY TO THE ORDER OF State Construction Company. $25,000.00

APR 10 1978

The sum of $25000 and 00 cts DOLLARS

CL. NO. 12HB-0108 IN PAYMENT OF LOSS WHICH OCCURRED AT ABOUT 19

POLICY NUMBER INSURED NAME & ADDRESS Minority Builders, Inc. Bond No. SBA-7990

Payable through
BANK OF LINCOLNWOOD
4433 W. TOUHY AVE.
70-2255 LINCOLNWOOD, ILLINOIS 70-2255

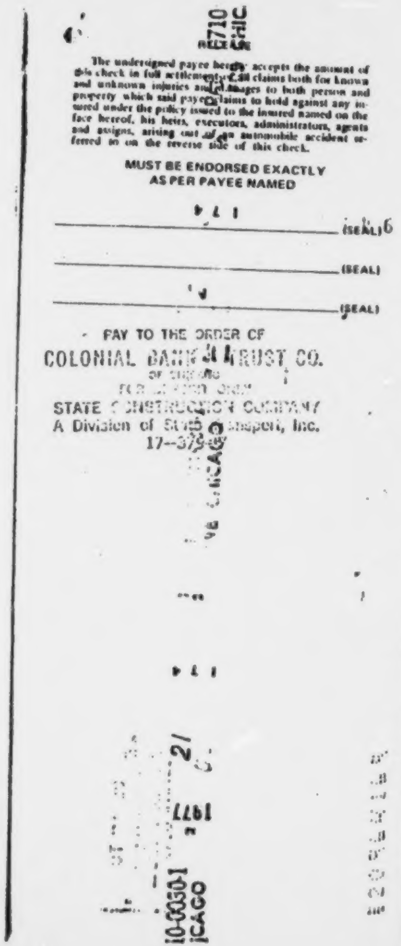
| SFX | COV | TYPE | AMT |
|---|---|---|---|
| 1. | 11 | P | $25,000.00 |
| | | | $ |

drf

THIS DRAFT VOID AFTER 90 DAYS
HERITAGE INSURANCE COMPANY OF AMERICA
CLAIM ACCOUNT

Joseph N Morreale

⑆0719⑉2255⑆ 09⑉9902 4⑈ ⑈0002500000⑈



RELEASE

The undersigned payee hereby accepts the amount of this check in full settlement of all claims both for known and unknown injuries and damages to both person and property which said payee claims to hold against any insured under the policy issued to the insured named on the face hereof, his heirs, executors, administrators, agents and assigns, arising out of an automobile accident referred to on the reverse side of this check.

MUST BE ENDORSED EXACTLY
AS PER PAYEE NAMED

_______________ (SEAL)

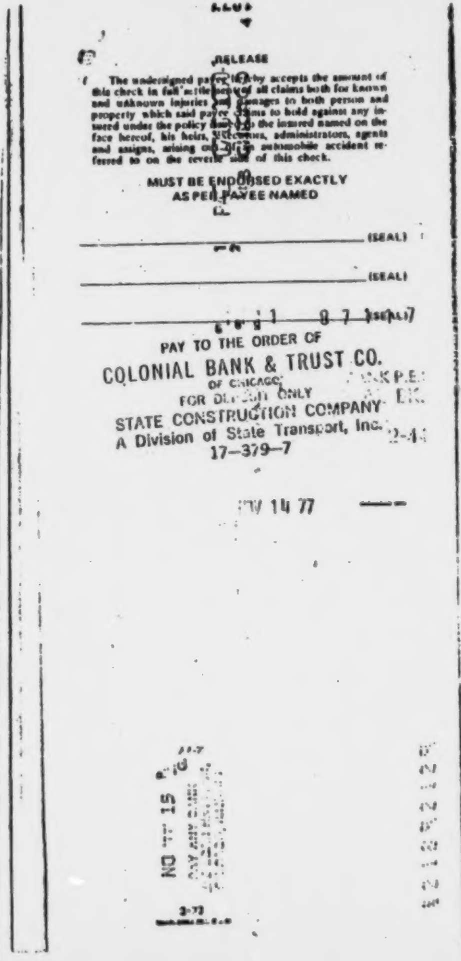
_______________ (SEAL)

_______________ (SEAL)

PAY TO THE ORDER OF
COLONIAL BANK & TRUST CO.
OF CHICAGO
FOR DEPOSIT ONLY
STATE CONSTRUCTION COMPANY
A Division of State Transport, Inc.
17-379-7

1977

10-0030-1
ICAGO



RELEASE

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MUST BE ENDORSED EXACTLY
AS PER PAYEE NAMED

_______________ (SEAL)

_______________ (SEAL)

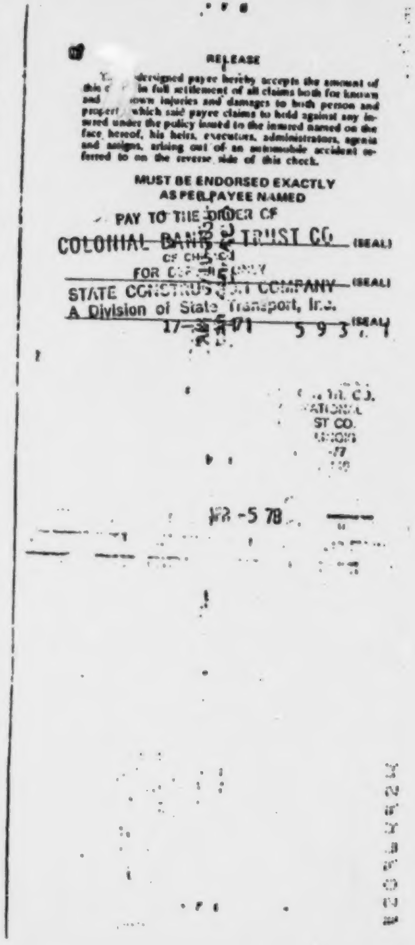
_______________ (SEAL)

PAY TO THE ORDER OF
COLONIAL BANK & TRUST CO.
OF CHICAGO
FOR DEPOSIT ONLY
STATE CONSTRUCTION COMPANY
A Division of State Transport, Inc.
17-379-7

NOV 14 77

NOV 15

PAY ANY BANK



RELEASE

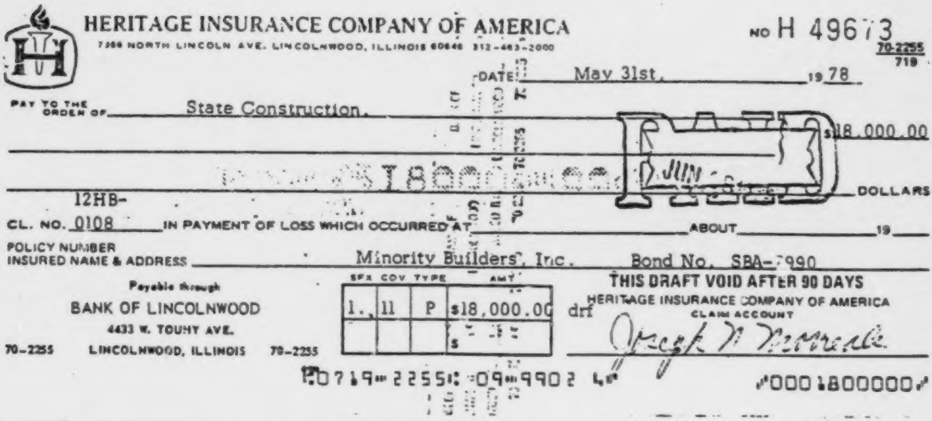
The undersigned payee hereby accepts the amount of this check in full settlement of all claims both for known and unknown injuries and damages to both person and property which said payee claims to hold against any insured under the policy issued to the insured named on the face hereof, his heirs, executors, administrators, agents and assigns, arising out of an automobile accident referred to on the reverse side of this check.

MUST BE ENDORSED EXACTLY
AS PER PAYEE NAMED

PAY TO THE ORDER OF
COLONIAL BANK & TRUST CO. (SEAL)
OF CHICAGO
FOR DEPOSIT ONLY
STATE CONSTRUCTION COMPANY (SEAL)
A Division of State Transport, Inc.
17-379-7 (SEAL)

NATIONAL
ST CO.

MAR -5 78



HERITAGE INSURANCE COMPANY OF AMERICA
7366 NORTH LINCOLN AVE. LINCOLNWOOD, ILLINOIS 60646 312-463-2000

NO H 49673
70-2255
719

DATE May 31st, 1978

PAY TO THE ORDER OF State Construction. $18,000.00

$18000 DOLLARS

PAID JUN

12HB-
CL. NO. 0108 IN PAYMENT OF LOSS WHICH OCCURRED AT ______ ABOUT ______ 19__

POLICY NUMBER
INSURED NAME & ADDRESS Minority Builders, Inc. Bond No. SBA-7990

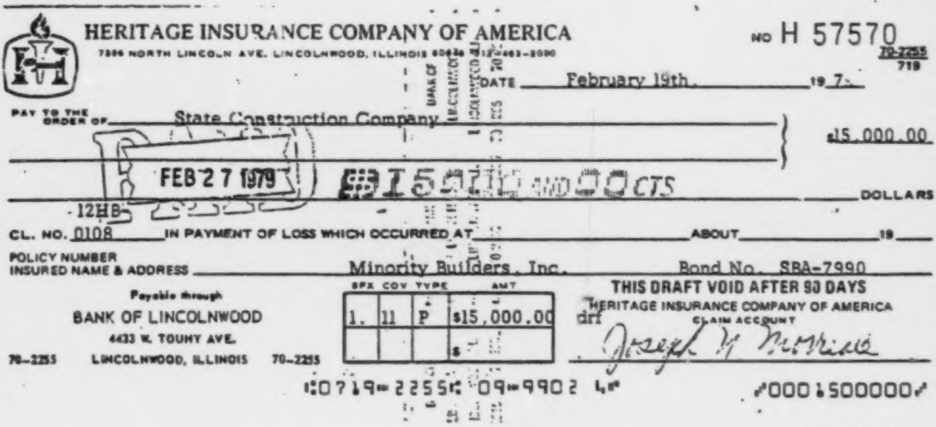
Payable through
BANK OF LINCOLNWOOD
4433 W. TOUHY AVE.
70-2255 LINCOLNWOOD, ILLINOIS 70-2255

| SFX | COV | TYPE | AMT |
|---|---|---|---|
| 1. | 11 | P | $18,000.00 |
|  |  |  | $ |

drf

THIS DRAFT VOID AFTER 90 DAYS
HERITAGE INSURANCE COMPANY OF AMERICA
CLAIM ACCOUNT
Joseph N. Morrill

⑆0719⑉2255⑆ 09⑉9902 4⑈ ⑈0001800000⑈



HERITAGE INSURANCE COMPANY OF AMERICA
7366 NORTH LINCOLN AVE. LINCOLNWOOD, ILLINOIS 60646 312-463-2000

NO H 57570
70-2255
719

DATE February 19th, 197-

PAY TO THE ORDER OF State Construction Company $15,000.00

$15000 AND 00 CTS DOLLARS

PAID FEB 27 1979

12HB-
CL. NO. 0108 IN PAYMENT OF LOSS WHICH OCCURRED AT ______ ABOUT ______ 19__

POLICY NUMBER
INSURED NAME & ADDRESS Minority Builders, Inc. Bond No. SBA-7990

Payable through
BANK OF LINCOLNWOOD
4433 W. TOUHY AVE.
70-2255 LINCOLNWOOD, ILLINOIS 70-2255

| SFX | COV | TYPE | AMT |
|---|---|---|---|
| 1. | 11 | P | $15,000.00 |
|  |  |  | $ |

drf

THIS DRAFT VOID AFTER 90 DAYS
HERITAGE INSURANCE COMPANY OF AMERICA
CLAIM ACCOUNT
Joseph N. Morrill

⑆0719⑉2255⑆ 09⑉9902 4⑈ ⑈0001500000⑈

RELEASE

The undersigned payee hereby accepts the amount of this check in full settlement of all claims both for known and unknown injuries and damages to both person and property which said payee claims to hold against any insured under the policy issued to the insured named on the face hereof, his heirs, executors, administrators, agents and assigns, arising out of an automobile accident referred to on the reverse side of this check.

MUST BE ENDORSED EXACTLY
AS PER PAYEE NAMED

______________________ (SEAL)

______________________ (SEAL)

______________________ (SEAL)

PAY TO THE ORDER OF
COLONIAL BANK & TRUST CO.
OF CHICAGO
FOR DEPOSIT ONLY
STATE TRANSPORT, INC.
17-379-7

BANK
2-446

PAY TO THE ORDER OF
COLONIAL BANK & TRUST CO.
OF CHICAGO
FOR DEPOSIT ONLY
STATE CONSTRUCTION COMPANY
A Division of State Transport, Inc.
17-379-7

---

RELEASE

The undersigned payee hereby accepts the amount of this check in full settlement of all claims both for known and unknown injuries and damages to both person and property which said payee claims to hold against any insured under the policy issued to the insured named on the face hereof, his heirs, executors, administrators, agents and assigns, arising out of an automobile accident referred to on the reverse side of this check.

MUST BE ENDORSED EXACTLY
AS PER PAYEE NAMED

______________________ (SEAL)

______________________ (SEAL)

______________________ (SEAL)

PAY TO THE ORDER OF
COLONIAL BANK & TRUST CO.
OF CHICAGO
FOR DEPOSIT ONLY
STATE CONSTRUCTION COMPANY
A Division of State Transport, Inc.
17-379-7

1978

0710 0030-1
CHICAGO

FB '77 23
PAY ANY BANK
AMERICAN NAT'L BK.
CHICAGO, ILLINOIS

UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF ILLINOIS
EASTERN DIVISION

| | | |
|---|---|---|
| UNITED STATES OF AMERICA<br>v.<br>MELVIN S. DICK and<br>ANTHONY GIACOMINO | ) | No ______________<br>Violations: Title 18, United States Code, Sections 1341 and 1001 |

The SPECIAL OCTOBER 1980 GRAND JURY charges:

1. At all times material to this indictment:

(a) MELVIN S. DICK, defendant herein, was an attorney and member of the Bar of the State of Illinois, engaged in the practice of law with offices located at 7366 North Lincoln Avenue, Lincolnwood, Illinois.

(b) ANTHONY GIACOMINO, defendant herein, represented himself as president and owner of State Construction Company, a subsidiary of State Transport, Inc., located at 2810 South Ellis Avenue, Elk Grove, Illinois.

(c) The Small Business Administration (SBA) was an agency of the United States government, with offices located in Chicago, Illinois, Washington, D. C., and Arlington, Virginia. The SBA administered the Surety Bond Guaranty Program, which was designed to assist certain small businesses obtain bid, payment, and performance bonds written by private insurance companies. The Surety Bond Guaranty Program provided for SBA reimbursement of 90 percent of any losses up to and including $250,000 sustained by insurance companies issuing performance bonds under said Program.

(d) Heritage Insurance Company of America (Heritage) and American Fidelity Fire Insurance Company (American Fidelity) were insurance companies duly licensed to transact business in the State of Illinois.

Heritage and American Fidelity retained the services of MELVIN S. DICK with respect to losses incurred on certain bonds guaranteed by the SBA Surety Bond Guaranty Program. Among his duties and responsibilities to Heritage and American Fidelity, MELVIN S. DICK was responsible for securing completion contractors on defaulted contracts, monitoring and requesting payouts from Heritage and American Fidelity to the completion contractors and others, and to act in Heritage's and American Fidelity's best and sole interests in minimizing losses and potential losses on bonds issued by those companies.

(e) Bergen Construction Corporation (Bergen) was a general contractor which in September, 1976, entered into an agreement with the Public Building Commission of Chicago to fully construct the Far North Police Station located at 6464 North Clark Street, Chicago, Illinois.

(f) Minority Builders, Inc. (Minority) subcontracted with Bergen to furnish substantially all of the concrete work on the police station for a price of $213,500. Minority secured a performance bond written on behalf of Heritage and American Fidelity, which bond was guaranteed by the SBA pursuant to the Surety Bond Guaranty Program. On September 12, 1977, Minority was declared to be in default of its contract with Bergen.

(g) Concrete Structures of the Midwest, Inc. (Concrete Structures) was a firm specializing in concrete work with business offices located in Wheaton, Illinois.

2. From in or about August, 1977, to and including December 2, 1981, at Elk Grove, and Lincolnwood, in the Northern District of Illinois, Eastern Division, and elsewhere,

MELVIN S. DICK and
ANTHONY GIACOMINO,

defendants herein, devised and intended to devise a scheme to:

(a) defraud Heritage and American Fidelity of:

(1) money;

(2) their right to have completion contractors retained, and losses on completion contracts calculated, honestly, fairly and free from craft, trickery, deceit, corruption, dishonesty and fraud; and

(3) the loyal and faithful performance of MELVIN S. DICK in his duties as an attorney retained by Heritage and American Fidelity to protect and promote their interests;

(b) defraud the United States of America and the SBA of:

(1) money; and

(2) their right to have the SBA Surety Bond Guaranty Program conducted honestly, fairly, and free from craft, trickery, deceit, corruption, dishonesty, and fraud.

3. It was part of the scheme to defraud that from August, 1977, to and including December 2, 1981, the defendants, MELVIN S. DICK and ANTHONY GIACOMINO, in complete disregard of the fiduciary duty owed by MELVIN S. DICK to Heritage and American Fidelity, would and did manipulate and falsely report, and cause to be manipulated and falsely reported, information supplied to Heritage, American Fidelity, and the SBA, primarily through rigging bids and executing a contract for the completion of the Far North Police Station concrete work at a falsely and fraudulently inflated price.

4. It was further a part of the scheme to defraud that on October 6, 1977, defendant MELVIN S. DICK falsely reported to Heritage and to the SBA that bids had been solicited and received prior to the award of the completion contract, and that State Construction was the lowest bidder at $196,000, when in truth and in fact no true, genuine, and competitive bids had been either solicited or received for said contract.

5. It was further a part of the scheme to defraud that on September 26, 1977, defendant MELVIN S. DICK, in his capacity as attorney for Heritage and American Fidelity, would and did sign a contract on behalf of Heritage and American Fidelity with

defendant ANTHONY GIACOMINO of State Construction for the completion of cement work left unfinished by Minority at the Far North Police Station. The amount to be paid to State Construction under the contract was $196,000, a price substantially in excess of a fair and honest price for the completion work.

6. It was further a part of the scheme to defraud that on September 24, 1977, defendant ANTHONY GIACOMINO accepted a contract proposal of Concrete Structures to complete all remaining concrete work on the Far North Police Station for a price of $88,650.

7. It was further a part of the scheme to defraud that defendants MELVIN S. DICK and ANTHONY GIACOMINO would and did thereafter, through false and misleading representations, conceal from Heritage, American Fidelity, and the SBA:

(a) that Concrete Structures had been employed by State Construction to perform the concrete completion work;

(b) that Concrete Structures did in fact perform the completion work; and

(c)that State Constrution did not actually perform the completion work.

8. It was further a part of the scheme to defraud that MELVIN S. DICK and ANTHONY GIACOMINO caused to be altered waivers of lien executed by Concrete Structures' cement supplier in order to:

(a) make it falsely appear as if the cement had actually been sold to State Construction Company, as well as Concrete Structures; and

(b) make if falsely appear that cement was supplied for the completion work at a price substantially in excess of that actually paid by Concrete Structures.

9. It was further a part of the scheme to defraud that defendants MELVIN S. DICK and ANTHONY GIACOMINO supplied and caused to be supplied to Heritage false and fraudulent contractor affidavits signed by defendant ANTHONY GIACOMINO, which affidavits falsely stated that the completion work was performed by State Construction, and which fraudulently concealed the fact that Concrete Structures actually performed the completion work.

10. It was further a part of the scheme to defraud that defendant MELVIN S. DICK would and did request that Heritage make payments to State Construction for the completion work which had been falsely reported by the defendants as having been performed by State Construction under the inflated contract price. The dates and amounts of payments to State Construction are as follows:

| DATE OF HERITAGE DRAFT | AMOUNT OF PAYMENT TO STATE CONSTRUCTION |
|---|---|
| October 17, 1977 | $ 91,728.00 |
| November 10, 1977 | 42,400.00 |
| March 31, 1978 | 25,000.00 |
| May 31, 1978 | 18,000.00 |
| February 19, 1979 | 15,000.00 |

11. It was further a part of the scheme to defraud that defendant ANTHONY GIACOMINO would and did cash and deposit and cause to be cashed and deposited said checks into an account maintained by State Construction.

12. It was further a part of the scheme to defraud that defendants MELVIN S. DICK and ANTHONY GIACOMINO caused Heritage to seek and receive reimbursement from the SBA for 90 percent of the amount of the payments made to State Construction which are detailed in paragraph 10 above.

13. It was further a part of the scheme to defraud that defendant ANTHONY GIACOMINO, through Green Lakes Landscaping, Inc., supplied substantial and expensive landscaping work to the personal residence of MELVIN S. DICK and to other properties at the direction of MELVIN S. DICK, free of charge.

14. It was further a part of the scheme to defraud that on May 30, 1978, MELVIN S. DICK reported to Heritage and the SBA that State Construction had completed all work required by the completion contract.

15. It was further part of the scheme to defraud that in the first week of September, 1980, during the course of an SBA audit of the Minority bond, MELVIN S. DICK provided SBA auditors, William Ryan and Richard E. Berger, with false and

misleading written bids in an attempt to justify the fraudulently inflated completion contract price.

16. It was further a part of the scheme to defraud that in the first week of September, 1980, during the course of an SBA audit of the Minority bond, MELVIN S. DICK provided SBA auditors, William Ryan and Richard E. Berger, with the altered lien waivers described more fully in paragraph 8 above.

17. It was further a part of the scheme to defraud that in the first week of September, 1980, during the course of an SBA audit of Minority bond, MELVIN S. DICK provided SBA auditors, William Ryan and Richard E. Berger, with false contractor affidavits executed by ANTHONY GIACOMINO which are described more fully in paragraph 9 above.

18. It was further a part of the scheme to defraud that ANTHONY GIACOMINO, in an attempt to conceal the scheme to defraud on September 11, 1980, falsely told SBA auditor William Ryan that State Construction records relating to the Far North Police Station had been destroyed in a fire.

19. It was further a part of the scheme to defraud that MELVIN S. DICK billed Heritage in excess of $16,000 in fees for services provided in connection with the Minority bond default.

20. On or about October 6, 1977, at Lincolnwood, in the Northern District of Illinois, Eastern Division,

MELVIN S. DICK and
ANTHONY GIACOMINO,

defendants herein, for the purpose of executing the aforesaid scheme to defraud, did knowingly cause to be placed in an authorized depository for mail matter to be sent and delivered by the United States Postal Service, according to the directions thereon, an envelope addressed to the SBA, Washington, D. C., containing a copy of a letter dated October 6, 1977 to Heritage Insurance Company from Melvin S. Dick, with attachments;

In violation of Title 18, United States Code, Section 1341.

## COUNT TWO

The SPECIAL OCTOBER 1980 GRAND JURY further charges:

1. Paragraphs 1 through 19 of Count One of this indictment are realleged and incorporated herein as if fully set forth.

2. On or about October 14, 1977, at Lincolnwood, in the Northern District of Illinois, Eastern Division,

MELVIN S. DICK and
ANTHONY GIACOMINO,

defendants herein, for the purpose of executing the aforesaid scheme to defraud, did knowingly cause to be delivered by the United States Postal Service, according to the directions thereon, an envelope containing a State Construction Company invoice, Contractor's Affidavit, Pay Out Order, and Partial Waiver of Lien, all dated October 14, 1977, addressed to:

Mr. Melvin S. Dick
7366 North Lincoln Avenue
Lincolnwood, Illinois 60046;

In violation of Title 18, United States Code, Section 1341.

## COUNT THREE

The SPECIAL OCTOBER 1980 GRAND JURY further charges:

1. Paragraphs 1 through 19 of Count One of this indictment are realleged and incorporated herein as if fully set forth.

2. On or about November 3, 1977, at Palatine, in the Northern District of Illinois, Eastern Division,

MELVIN S. DICK and
ANTHONY GIACOMINO,

defendants herein, for the purposes of executing the aforesaid scheme to defraud, did knowingly cause to be delivered by the United States Postal Service, according to the directions thereon, an envelope containing a letter from ANTHONY GIACOMINO to Bergen Construction Corporation dated November 2, 1977, addressed to:

Bergen Construction Corporation
55 West Wood Street
Palatine, Illinois 60067;

In violation of Title 18, United States Code, Section 1341.

## COUNT FOUR

The SPECIAL OCTOBER 1980 GRAND JURY further charges:

1. Paragraphs 1 through 19 of Count One of this indictment are realleged and incorporated herein as if fully set forth.

2. On or about November 15, 1977, at Palatine, in the Northern District of Illinois, Eastern Division,

MELVIN S. DICK and
ANTHONY GIACOMINO,

defendants herein, for the purpose of executing the aforesaid scheme to defraud, did knowingly cause to be delivered by the United States Postal Service, according to the directions thereon, an envelope containing a letter from ANTHONY GIACOMINO to Bergen Construction Corporation dated November 14, 1977, addressed to:

Bergen Construction Corporation
55 West Wood Street
Palatine, Illinois 60067;

In violation of Title 18, United States Code, Section 1341.

## COUNT FIVE

The SPECIAL OCTOBER 1980 GRAND JURY further charges:

1. Paragraphs 1 through 19 of Count One of this indictment are realleged and incorporated herein as if fully set forth.

2. On or about November 15, 1977, at Lincolnwood, in the Northern District of Illinois, Eastern Division,

MELVIN S. DICK and
ANTHONY GIACOMINO,

defendants herein, for the purpose of executing the aforesaid scheme to defraud, did knowingly cause to be delivered by the United States Postal Service, according to the directions thereon, an envelope containing a carbon copy of a letter from ANTHONY GIACOMINO of State Construction to Bergen Construction Corporation dated November 14, 1977, addressed to:

Dick and Thomas
7366 No. Lincoln
Lincolnwood, Illinois;

In violation of Title 18, United States Code, Section 1341.

## COUNT SIX

The SPECIAL OCTOBER 1980 GRAND JURY further charges:

1. Paragraphs 1 through 19 of Count One of this indictment are realleged and incorporated herein as if fully set forth.

2. On or about February 10, 1978,

MELVIN S. DICK and
ANTHONY GIACOMINO,

defendants herein, for the purpose of executing the aforesaid scheme to defraud, did knowingly cause to be delivered by the United States Postal Service, according to the directions thereon, an envelope containing United States Treasury Check Number 5,227, 762, Symbol 3004, in the amount of $364,209.20 and payable to Heritage Insurance Company of America, said envelope being addressed to:

Heritage Insurance Company
of America
7366 North Lincoln Avenue
Lincolnwood, Illinois 60646;

In violation of Title 18, United States Code, Section 1341.

## COUNT SEVEN

The SPECIAL OCTOBER 1980 GRAND JURY further charges:

1. Paragraphs 1 through 19 of Count One of this indictment are realleged and incorporated herein as if fully set forth.

2. On or about May 22, 1978, in Palatine, in the Northern District of Illinois, Eastern Division,

MELVIN S. DICK and
ANTHONY GIACOMINO,

defendants herein, for the purpose of executing the aforesaid scheme to defraud, did knowingly cause to be delivered by the United States Postal Service according to the directions thereon, an envelope containing a letter dated May 22, 1978, to Mr. David Bergen from George R. Cohan, Fogel and Associates, Inc., New Terminal Building, Detroit City Airport, Detroit, Michigan, 48213, said envelope being addressed to:

Mr. David Bergen
Bergen Construction Company
55 West Wood Street
Palatine, Illinois 60067

In violation of Title 18, United States Code, Section 1341.

## COUNT EIGHT

The SPECIAL OCTOBER 1980 GRAND JURY further charges:

1. Paragraphs 1 through 19 of Count One of this indictment are realleged and incorporated herein as if fully set forth.

2. On or about May 31, 1978, in Chicago, in the Northern District of Illinois, Eastern Division,

MELVIN S. DICK and
ANTHONY GIACOMINO,

defendants herein, for the purpose of executing the aforesaid scheme to defraud, did knowingly cause to be delivered by the United States Postal Service, according to the directions thereon, an envelope addressed to the SBA, Chicago, Illinois, containing a copy of a letter dated May 30, 1978, to Heritage Insurance Company from MELVIN S. DICK;

In violation of Title 18, United States Code, Section 1341.

## COUNT NINE

The SPECIAL OCTOBER 1980 GRAND JURY further charges:

1. Paragraphs 1 through 19 of Count One of this indictment are realleged and incorporated herein as if fully set forth.

2. On or about July 19, 1978, in Lincolnwood, in the Northern District of Illinois, Eastern Division,

MELVIN S. DICK and
ANTHONY GIACOMINO,

defendants herein, for the purpose of executing the aforesaid scheme to defraud, did knowingly cause to be delivered by the United States Postal Service according to the directions thereon, an envelope containing United States Treasury Check Number 58,686, 532, Symbol 3004, in the amount of $113,778.58, and payable to Heritage Insurance Company of America, said envelope being addressed to:

Heritage Insurance Company
of America
7366 North Lincoln Avenue
Lincolnwood, Illinois 60646;

In violation of Title 18, United States Code, Section 1341.

## COUNT TEN

The SPECIAL OCTOBER 1980 GRAND JURY further charges:

1. Paragraphs 1 through 19 of Count One of this indictment are realleged and incorporated herein as if fully set forth.

2. On or about August 14, 1978, in Lincolnwood, in the Northern District of Illinois, Eastern Division,

MELVIN S. DICK and
ANTHONY GIACOMINO,

defendants herein, for the purpose of executing the aforesaid scheme to defraud, did knowingly cause to be delivered by the United States Postal Service according to the directions thereon, an envelope containing United States Treasury Check Number 9,323,780, Symbol 3004, in the amount of $99,185.34, and payable to Heritage Insurance Company of America, said envelope being addressed to:

Heritage Insurance Company
of America
7366 North Lincoln Avenue
Lincolnwood, Illinois 60646;

In violation of Title 18, United States Code, Section 1341.

## COUNT ELEVEN

The SPECIAL OCTOBER 1980 GRAND JURY further charges:

1. Paragraphs 1 through 19 of Count One of this indictment are realleged and incorporated herein as if fully set forth.

2. On or about June 8, 1979, in Lincolnwood, in the Northern District of Illinois, Eastern Division,

MELVIN S. DICK and
ANTHONY GIACOMINO,

defendants herein, for the purpose of executing the aforesaid scheme to defraud, did knowingly cause to be delivered by the United States Postal Service according to the directions thereon, an envelope containing United States Treasury Check Number 16,445, 963, Symbol 3004, in the amount of $127,408.97 and payable to Heritage Insurance Company of America, said envelope being addressed to:

Heritage Insurance Company
of America
7366 North Lincoln Avenue
Lincolnwood, Illinois 60646;

In violation of Title 18, United States Code, Section 1341.

## COUNT TWELVE

The SPECIAL OCTOBER 1980 GRAND JURY further charges:

1. The grand jury realleges and incorporates by reference paragraph 1(a) through 1(g) of this indictment as though fully set forth herein.

2. On or about October 6, 1977, at Chicago, in the Northern District of Illinois, Eastern Division,

MELVIN S. DICK, and
ANTHONY GIACOMINO,

defendants herein, knowingly and willfully did make, and cause to be made, false, fictitious and fraudulent statements and representations as to material facts in a matter within the jurisdiction of an agency of the United States, that is, the SBA, in that they submitted and caused to be submitted to the SBA in Chicago a letter from Melvin S. Dick dated October 6, 1977, to Heritage Insurance Company; which letter contained false, fictitious and fraudulent representations that certain bids were procured by telephone for the completion of concrete work at the Far North Police Station, when in truth and in fact, no genuine, true and competitive bids had been, obtained, as the defendants,

MELVIN S. DICK and
ANTHONY GIACOMINO,

then well knew;

In violation of Title 18, United States Code, Section 1001.

## COUNT THIRTEEN

The SPECIAL OCTOBER 1980 GRAND JURY further charges:

1. The grand jury realleges and incorporates by reference paragraphs 1(a) through 1(g) of this indictment as though fully set forth herein.

2. On or about November 21, 1977, at Chicago, in the Northern District of Illinois, Eastern Division,

MELVIN S. DICK and
ANTHONY GIACOMINO,

defendants herein, knowingly and willfully did make, and cause to be made, false, fictitious and fraudulent statements and representations as to material facts in a matter within the jurisdiction of an agency of the United States, that is, the SBA, in that they submitted and caused to be submitted a copy of a letter dated November 21, 1977 to Heritage from Melvin S. Dick with an attached report of George R. Cohan; which letter and attachment contained false, fictitious and fraudulent representations that the reason for the loss on the Minority bond was primarily an original under bid by Minority, when in truth and in fact the primary reason for the loss was the execution of a falsely and fraudulently inflated completion contract, as the defendants,

MELVIN S. DICK and
ANTHONY GIACOMINO,

then well knew;

In violation of Title 18, United States Code, Section 1001.

## COUNT FOURTEEN

The SPECIAL OCTOBER 1980 GRAND JURY further charges:

1. The grand jury realleges and incorporates by reference paragraphs 1(a) through 1(g) of this indictment as though fully set forth herein.

2. In or about the first week of September, 1980, at Lincolnwood, in the Northern District of Illinois, Eastern Division,

MELVIN S. DICK and
ANTHONY GIACOMINO,

defendants herein, knowingly and willfully did make, and cause to be made, false, fictitious and fraudulent statements and representations as to material facts in a matter within the jurisdiction of an agency of the United States, that is, the SBA, in that they submitted and caused to be submitted to SBA auditors William Ryan and Richard E. Berger an altered partial waiver of lien dated September 29, 1977; which partial waiver of lien contained false, fictitious and fraudulent representations that concrete had been furnished to Concrete Structures and State Construction Company for $34,075.60, when in truth and in fact the concrete had been furnished solely to Concrete Structures, not State Construction, for $4,075.60, as the defendants,

MELVIN S. DICK and
ANTHONY GIACOMINO,

then well knew;

In violation of Title 18, United States Code, Section 1001.

## COUNT FIFTEEN

The SPECIAL OCTOBER 1980 GRAND JURY further charges:

1. The grand jury realleges and incorporates by reference paragraphs 1(a) through 1(g) of this indictment as though fully set forth herein.

2. In or about the first week of September, 1980, at Lincolnwood, in the Northern District of Illinois, Eastern Division,

MELVIN S. DICK and
ANTHONY GIACOMINO,

defendants herein, knowingly and willfully did make, and cause to be made, false, fictitious and fraudulent statements and representations as to material facts in a matter within the jurisdiction of an agency of the United States, that is, the SBA, in that they submitted and caused to be submitted to SBA auditors William Ryan and Richard E. Berger an altered partial waiver of lien dated December 30, 1977, which partial waiver of lien contained false, fictitious and fraudulent representations that concrete had been furnished to Concrete Structures and State Construction Company, when in truth and in fact the concrete had been furnished solely to Concrete Structures, not State Construction, as the defendants,

MELVIN S. DICK and
ANTHONY GIACOMINO,

then well knew;

In violation of Title 18, United States Code, Section 1001.

## COUNT SIXTEEN

The SPECIAL OCTOBER 1980 GRAND JURY further charges:

1. The grand jury realleges and incorporates by reference paragraphs 1(a) through 1(g) of this indictment as though fully set forth herein.

2. In or about the first week of September, 1980, at Lincolnwood, in the Northern District of Illinois, Eastern Division,

MELVIN S. DICK and
ANTHONY GIACOMINO,

defendants herein, knowingly and willfully did make, and cause to be made, false, fictitious and fraudulent statements and representations as to material facts in a matter within the jurisdiction of an agency of the United States, that is, the SBA, in that they submitted and caused to be submitted to SBA auditors William Ryan and Richard E. Berger an altered final waiver of lien dated May 25, 1978; which final waiver of lien contained false, fictitious and fraudulent representations that concrete had been furnished to Concrete Structures and State Construction Company, when in truth and in fact the concrete had been furnished solely to Concrete Structures, not State Construction, as the defendants,

MELVIN S. DICK and
ANTHONY GIACOMINO,

then well knew;

In violation of Title 18, United States Code, Section 1001.

## COUNT SEVENTEEN

The SPECIAL OCTOBER 1980 GRAND JURY further charges:

1. The grand jury realleges and incorporates by reference paragraph 1(a) through 1(g) of this indictment as though fully set forth herein.

2. In or about the first week of September, 1980, at Lincolnwood, in the Northern District of Illinois, Eastern Division,

MELVIN S. DICK, and
ANTHONY GIACOMINO,

defendants herein, knowingly and willfully did make, and cause to be made, false, fictitious and fraudulent statements and representations as to material facts in a matter within the jurisdiction of the United States, that is, the SBA, in that they submitted and caused to be submitted to SBA auditors William Ryan and Richard E. Berger a Contractor's Affidavit dated October 14, 1977; which affidavit contained false, fictitious and fraudulent representations that State Construction Company was the only party who had furnished or who had been contracted with by ANTHONY GIACOMINO to furnish material or labor for the concrete work on the building located at 6464 North Clark Street, Chicago, Illinois, when in truth and in fact Concrete Structures, not State Construction, performed the concrete work at that location, as the defendants,

MELVIN S. DICK and
ANTHONY GIACOMINO,

then well knew;

In violation of Title 18, United States Code, Section 1001.

## COUNT EIGHTEEN

The SPECIAL OCTOBER 1980 GRAND JURY further charges:

1. The grand jury realleges and incorporates by reference paragraph 1(a) through 1(g) of this indictment as though fully set forth herein.

2. In or about the first week of September, 1980, at Lincolnwood, in the Northern District of Illinois, Eastern Division,

MELVIN S. DICK, and
ANTHONY GIACOMINO,

defendants herein, knowingly and willfully did make, and cause to be made, false, fictitious and fraudulent statements and representations as to material facts in a matter within the jurisdiction of the United States, that is, the SBA, in that they submitted and caused to be submitted to SBA auditors William Ryan and Richard E. Berger a Contractor's Affidavit dated November 4, 1977; which affidavit contained false, fictitious and fraudulent representations that State Construction Company and Material Services Corporation were the only parties who had furnished or who had been contracted with by ANTHONY GIACOMINO to furnish material or labor for the concrete work on the building located at 6464 North Clark Street, Chicago, Illinois, when in truth and in fact Concrete Structures, not State Construction, performed the concrete work at that location, as the defendants,

MELVIN S. DICK and
ANTHONY GIACOMINO,

then well knew;

In violation of Title 18, United States Code, Section 1001.

## COUNT NINETEEN

The SPECIAL OCTOBER 1980 GRAND JURY further charges:

1. The grand jury realleges and incorporates by reference paragraph 1(a) through 1(g) of this indictment as though fully set forth herein.

2. In or about the first week of September, 1980, at Lincolnwood, in the Northern District of Illinois, Eastern Division,

MELVIN S. DICK, and
ANTHONY GIACOMINO,

defendants herein, knowingly and willfully did make, and cause to be made, false, fictitious and fraudulent statements and representations as to material facts in a matter within the jurisdiction of the United States, that is, the SBA, in that they submitted and caused to be submitted to SBA auditors William Ryan and Richard E. Berger a Contractor's Affidavit dated April 3, 1978; which affidavit contained false, fictitious and fraudulent representations that State Construction Company was the only party who had furnished or who had been contracted with by ANTHONY GIACOMINO to furnish material or labor for the concrete work on the building located at 6464 North Clark Street, Chicago, Illinois, when in truth and in fact Concrete Structures, not State Construction, performed the concrete work at that location, as the defendants,

MELVIN S. DICK and
ANTHONY GIACOMINO,

then well knew;

In violation of Title 18, United States Code, Section 1001.

## COUNT TWENTY

The SPECIAL OCTOBER 1980 GRAND JURY further charges:

1. The grand jury realleges and incorporates by reference paragraph 1(a) through 1(g) of this indictment as though fully set forth herein.

2. In or about the first week of September, 1980, at Lincolnwood, in the Northern District of Illinois, Eastern Division,

MELVIN S. DICK, and
ANTHONY GIACOMINO,

defendants herein, knowingly and willfully did make, and cause to be made, false, fictitious and fraudulent statements and representations as to material facts in a matter within the jurisdiction of the United States, that is, the SBA, in that they submitted and caused to be submitted to SBA auditors William Ryan and Richard E. Berger a Contractor's Affidavit dated May 25, 1978; which affidavit contained false, fictitious and fraudulent representations that State Construction Company and Material Services Corporation were the only parties who had furnished or who had been contracted with by ANTHONY GIACOMINO to furnish material or labor for the concrete work on the building located at 6464 North Clark Street, Chicago, Illinois, when in truth and in fact Concrete Structures, not State Construction, performed the concrete work at that location, as the defendants,

MELVIN S. DICK and
ANTHONY GIACOMINO,

then well knew;

In violation of Title 18, United States Code, Section 1001.

A TRUE BILL:

FOREPERSON

ACTING UNITED STATES ATTORNEY

DS/als/nw/wpc

## FACT SHEET

| | |
|---|---|
| Principal: | Wilson Iron Works<br>Malden, Massachusetts |
| Obligee: | Town of Duxbury, Massachusetts |
| Surety Bond Guarantee Number: | 100-10330-002-16 |
| Surety: | International Fidelity Insurance Company<br>Newwark, New Jersey |
| Underwriter: | Norman E. Daniel<br>Braintree, Massachusetts |
| Claims Adjuster: | David Samson of Kimmelman, Wolf & Samson<br>West Orange, New Jersey |
| Completion Contractor: | Jace Industries<br>Jericho, New York |
| Cost of Original Contract: | $208,470 |
| Loss to SBA: | $330,847 |

## BACKGROUND

In May 1976, International Fidelity Insurance Company (IFI) issued an SBA-guaranteed surety bond to Wilson Iron Works, which had obtained a $208,470 contract to repair a wooden bridge in Duxbury, Massachusetts. Wilson had apparently underbid the contract and lacked experience with wood construction. As a result, the company defaulted on December 16, 1976. At the time of default, the work was largely completed, with $30,500 in contract funds outstanding.

IFI employed David Samson as its claims attorney to process the default. Samson subsequently selected Jace Industries to complete the project. IFI issued an initial $130,000 completion contract to Jace, and a separate $5,000 contract to Jace for consulting work on the bridge repair. The completion contract was awarded on March 22, 1977. On March 16, 1977, Jace provided a subcontract to Long Island Dock of Massapequa, New York for $84,260 to complete the bridge project.

Corrective work was required to complete the repairs, and the Town of Duxbury agreed to pay IFI $98,279 to complete the work. The repair was finished in August 1977.

The total cost to complete the project for IFI was $403,711 in direct expenses, corrective work, and legal fees. This was more than four times the amount the Town believed the completion would cost. SBA paid 90 percent of these costs, or $372,306.

## FINDINGS

The SBA Office of Inspector General conducted an audit and investigation of this completion contract. In addition, the staff of the Senate Small Business Committee prepared a separate examination of this case.

The investigation showed fraud in the original contract to Wilson Iron Works. The principal of the company is Richard Wilson, Sr. However, his son, Richard Wilson, Jr., signed his parents' names to the bond and indemnity agreement. He was assisted by a notary public, who notarized the documents with the forged signatures. IFI sued the son and the notary, receiving substantial judgments against each individual.

The completion contract is of more concern to the Committee. The investigation found that Jace Industries simply acted as a broker on the contract. The subcontractor performed all of the physical repairs to the bridge, and could have completed the work without Jace, at substantially less cost to SBA and the surety.

The contract between IFI and Jace allowed Jace to collect additional payments in addition to the original contract price for corrective work. Samson and Mitterhoff approved all payments to Jace without verifying the firm's vouchers.

The principals of Jace, Calvin Zemsky and Joseph Bergianti, billed IFI for payments to Bob Cris Corporation, which was represented to the surety as a firm working on the completion project. In fact, evidence developed by Inspector General auditors clearly demonstrates that Bob Cris was a straw corporation created by Zemsky and Bergianti to collect additional payments from the surety.

The President and Secretary of Bob Cris were listed in the corporate resolution as the maiden names of the wives of Zemsky and Bergianti. The post office box address and telephone number listed for Bob Cris belonged to an employee of Jace Industries.

IFI payments for completion work included $153,544.63 to Long Island Dock; $90,215 to Jace Industries; and $21,900 to Bob Cris. The principals of Jace were paid a total $112,115, including the payments to Jace and Bob Cris. The investigation established that the $112,115 in payments to Jace and Bob Cris were primarily for the typing of 11 requisitions for payment and travel by Zemsky to the work site once a week for the purpose of totaling costs and approving items to be submitted to IFI each week.

Although Zemsky's wife was listed as an officer of Bob Cris (as was Bergianti's) he denied that he or Bergianti had any affiliation with Bob Cris, in interviews with Inspector General auditors and Committee staff.

Based on this information, it appears that IFI paid $112,115, at minimum, for unnecessary expenses. Long Island Dock stated that it completed the bridge repairs alone. SBA paid 90 percent of the completion costs.

The Inspector General investigation of this case is ongoing.

SMALL BUSINESS ADMINISTRATION

## APPLICATION FOR SURETY BOND GUARANTEE ASSISTANCE

NAME OF APPLICANT AND ITS PRINCIPAL
[illegible] Richard E. Wilson

APPLICANT'S HOME ADDRESS (include ZIP)
151 Malden Street
Malden, Massachusetts

APPLICANT'S BUSINESS ADDRESS (include ZIP)
34 Sharon Street
Malden, Massachusetts 02148

NAME OF BROKER/AGENT
Norman E. Daniel

BROKER/AGENT'S ADDRESS (include ZIP)
220 Forbes Road
Braintree, MA 02184

BROKER/AGENT'S TELEPHONE (Include Area Code)
(617)848-5605

NAME OF SURETY IF KNOWN
~~American Fidelity Fire Ins. Co.~~
Int'l Fidelity Insurance Co

1. Applicant hereby states and affirms the following:

a. The gross annual receipts of my business (including affiliates) during the past fiscal year was $ 170,000. , or as annually averaged over the past 3 fiscal years (to the nearest hundreds) was $ ________.

b. A bid, payment or performance bond is required on the following project or to serve as a primary contractor or subcontractor thereon.

c. Contractor certifies having attempted (and failed) to obtain the required bonds without the SBA's guarantee; furthermore, the contractor certifies being aware that some sureties charge higher premium rates for bonds than others do.

d. Brief description of project including projected job completion date or, on prequalification, size of job and total work in progress you feel you can handle.

repairs to the Powder Point Bridge in Duxbury, Mass. projected completion date six weeks from commencement

SURETY BOND GUARANTEE
REGION I

APR 30 1976

e. Approximate value of contract: $ 208,470.00 .

f. Applicant, in consideration of assistance from the SBA herewith agrees that it will comply with the nondiscrimination requirements of Title 13, Code of Federal Regulations, Part 112 and Part 113.

SBG # 10330-02
TO file
PER [illegible]

2. The date, time and place of the bid opening is as follows: (if applicable):

| Date | Time | Place |
|---|---|---|
| April 20, 1976 | 5:00 p.m. | Duxbury Town Hall |

3. I have read the "Contractor's Fee" section (reverse side) and agree to abide by this fee schedule, PROVIDED I receive the contract sought and SBA extends its bond guarantee. I also agree to pay the contractor's guarantee fee to my Agent/Broker at the time I receive the bond, in accordance with Paragraph 9, reverse side.

4. I presently ☒ do not have an SBA Loan ☐ previous loan or other program assistance
☐ do have an SBA Loan through the ________ office
with a balance of $ ________ as of (date) ________

5. I ☐ am ☒ am not an SBA 8(a) Qualified Contractor

This bond application ☐ does ☒ does not pertain to an 8(a) contract ☐ does ☒ does not pertain to SBG Bond Line of Credit

☒ have received previous SBA bond guarantee(s) ☐ have not received previous SBA bond guarantee(s)
If you have received previous SBA bond guarantee(s), have you ever defaulted on any of them? (Either under this contracting concern's trade name or any other concern's of which you have been a principal ☐ Yes ☒ No
If "yes", detailed particulars are to be attached to all four(4) copies of this application form. Particulars should include at least the following: (1) Name of Surety; (2) Name of Obligee; (3) SBG #w/Suffix Number; (4) Value of Contract; (5) Date of Default; (6) Status of Default/ Claim, i.e., amount of loss to Surety, etc.; (7) Contractor's narrative explanation as to reason for default and actions taken to meet the obligations to the Surety under terms of the bond(s).

6. Applicant hereby authorizes any agent, broker or surety company in possession of credit, financial or work experience information concerning the undersigned applicant and the applicant's business to release the same to SBA, in order that SBA may evaluate the same for the purpose of bond guarantee assistance.

Applicant certifies that any information he submits to any agent, broker or surety company for their evaluation as to the bondability of this contractor is correct and accurate to the best of the contractor's knowledge.

7. Any intentionally false statement in this application or willful misrepresentation relative thereto is a violation of federal law, which may subject you to criminal and civil prosecution, 18 U.S.C. Sections 267,371,1001, 15 U.S.C. Sections 645, 31 U.S.C. Section 231, carrying fines up to $10,000 and imprisonment up to five years."

I hereby certify that all information presented herein is complete and accurate to the best of my knowledge.

| SIGNATURE (Applicant) | | Executed this date |
|---|---|---|
| Richard E. Wilson | Owner | 4/27/76 |

SBA Form 994 (10-74) REF: SOP 50 45 PREVIOUS EDITIONS ARE OBSOLETE

WHITE COPY - SBA REGIONAL OFFICE
YELLOW COPY - SBA DISTRICT OFFICE
PINK COPY - SURETY
GOLDENROD COPY - PRODUCER (AGENT/BROKER)

557

27(a) CONTRACTOR HAVE BANK LINE OF CREDIT? ☐ YES ☐ NO
27(b) WITH WHOM?
27(c) HOW MUCH BANK LINE OF CREDIT?

28(a) VERIFICATION OF PAYABLES? ☐ YES ☐ NO
28(b) AGED? (% over 60 days)
28(c) HOW MANY?
28(d) OF HOW MANY?

29(a) VERIFICATION OF RECEIVABLES? ☐ YES ☐ NO
29(b) AGED? (% over 60 days)
29(c) HOW MANY?
29(d) OF HOW MANY?

30. ANY REMARKS FROM CREDITORS CONCERNING THIS CONTRACTOR

31(a) CONTRACTOR HAVE CURRENT SBA LOAN? ☐ YES ☐ NO
31(b) HOW MUCH & STATUS?
32(a) PREVIOUS SBA LOAN? ☐ YES ☐ NO
32(b) SBA LOAN APPL. PENDING? ☐ YES ☐ NO

33(a) CONTRACTOR PREVIOUSLY BONDED? ☐ YES ☐ NO
33(b) AMOUNT $
33(c) WITH WHOM?

34(a) CONTRACTOR HAVE BONDING LINE? ☐ YES ☐ NO
34(b) AMOUNT $
35(a) PREVIOUS SBA BOND GUAR.? ☐ YES ☐ NO
35(b) AMOUNT & STATUS

In our opinion, the principal appears to have the financial/management/technical abilities necessary to successfully complete this contract, however, we feel this contractor falls below the normal underwriting standards of our company, and we cannot issue bonds to this contractor without the SBA Guarantee

UNDERWRITER: Norman E. Daniel Norman E. Daniel
DATE: 4/29/76
ADDRESS (Include Zip Code): 220 Forbes Road, Braintree, MA 02184
TELEPHONE (Include A.C.): (617)848-5605

B. SMALL BUSINESS ADMINISTRATION'S REVIEW

1. SBG NO. (With Suffix): SBG # 10330-02
2(a) REVIEW OF INITIAL STAGE? ☐ YES ☑ NO
2(b) SUBSEQUENT STAGE? ☑ YES ☐ NO
3. MEETS SIZE STANDARDS? ☑ YES ☐ NO
4(a) CONTRACTOR NEEDS FIN/MGT/TECH ASSIST? ☐ YES ☑ NO
4(b) WHAT TYPE? —
5(a) REQUEST OTHER SBA ASSIST. MAG ETC.? ☐ YES ☑ NO
5(b) WHAT TYPE? —

6. IF NECESSARY ASSISTANCE IS NOT READILY AVAILABLE IN GOVERNMENT, HAVE YOU REFERRED APPLICANT TO FUNDED ASSISTANCE PROGRAMS I.E., MINORITY CONTRACTORS ASSISTANCE PROGRAM (MCAP) ETC.?
(NAME ASSISTANCE) —

7(a) BASED ON THE ABOVE THERE ☑ IS ☐ IS NOT REASON TO EXPECT SUCCESSFUL COMPLETION OF THE CONTRACT
7(b) THE COSTS ☑ DO ☐ DO NOT APPEAR TO BE REASONABLE
7(c) IT HAS BEEN DETERMINED THAT THE REQUESTED BOND(S) ☑ IS ☐ ARE NECESSARY AND THE SURETY COMPANY HAS INDICATED THAT IT WILL NOT ISSUE THE BOND(S) WITHOUT THE SBA GUARANTEE

8. REMARKS/CONCLUSIONS 2nd appl. - 1st SBGA 50% completed leaving $3.5M-bal. Good financial condition — Good experience background. Has a $4.0M Capacity for Work on Bridges + Structures for the Comm. of Mass. D.P.W. — Reason for need of SBGA is that they have never needed bonds before — Most of their work was subbing on Fabricated Steel — Personal G & A obtained And also corporate.

9. ATTACHMENTS (Check Appropriate Box)
(a) CONTINUATION SHEET ☐
(b) SBA FORM 990 ☑
(c) CONTRACTORS CURRENT FINANCIAL STATEMENT ☑
(d) COPIES OF BONDS ☐
(e) WE ARE IN RECEIPT OF SBA FORM 912 ☑ AND APPROPRIATE SBA FORM 994 FOR THIS CONTRACTOR AND JOB. ☑

10. RECOMMENDATION ✓ APPROVAL ☐ DISAPPROVAL

REVIEWING OFFICIAL (Signature): G. T. Olga
TITLE: SBO
DATE: 5/7/76

APPROVING OFFICIAL (Signature): Leonard E. Chadwick
LEONARD E. CHADWICK
TITLE: ARD/FI
DATE: May 7, 1976

SMALL BUSINESS ADMINISTRATION

## SURETY BOND GUARANTEE UNDERWRITING REVIEW

SURETY COMPANY: International Fidelity Ins. Co.

NAME OF PRINCIPAL: Richard E. Wilson, Owner

SBG # 10330-02

APPLICANT'S TRADE NAME AND ADDRESS:
Richard E. Wilson d/b/a Wilson
Iron Works
34 Sharon Street
Malden, MA 02148

Items 1-16 are to be completed on each Bond Guarantee Submission to SBA, including the initial Submission and All Subsequent Submissions

A. SURETY'S REVIEW

1 JOB DESCRIPTION AND LOCATION (Include Obligee): repairs to the Powder Point Bridge in Duxbury for the Town of Duxbury

2 CONTRACT AMOUNT (Amount of Bid, Based on Performance): $208,470.

2(a) BOND $ OR %: 100%

3 PENALTY CLAUSE: ☐ YES ☒ NO

4 BOND NUMBER:

5 IS PRESENT PROJECT SIMILAR TO PREVIOUS WORK PERFORMED? ☒ YES ☐ NO

6 WHEN DOES JOB BEGIN? asap

7 SCHEDULED COMPLETION DATE: 6 weeks fr. commencement

8 HOW MUCH AND STATUS OF WORK IN PROGRESS?
1. $49,000-Power Plant Operations for Comm. of Mass-50% completion

8(a) VERIFIED BY OBLIGEE(S): ☒ YES ☐ NO

8(b) HOW MANY? n/a

8(c) OF HOW MANY?

8(d) HAS SURETY CHECKED WITH SUPPLIERS? ☒ YES ☐ NO

8(e) HOW MANY? n/a

8(f) OF HOW MANY?

9(a) DATE OF FINANCIAL STATEMENT: 1/12/76 FY END

9(b) IS THERE SUFFICIENT WORKING CAPITAL? ☒ YES ☐ NO

10(a) FINAL (PAYMENT/PERFORMANCE) BOND DUE: ☐ YES ☒ NO

10(b) WHAT IS BID SPREAD? $25,000. 10.7%

NOTE: If this review is for a bid bond request, the Surety must forward SBA a listing of the Bid Spread prior to Surety's issuance of the final bonds

11(a) SUBCONTRACTORS INVOLVED IN THIS JOB? ☐ YES ☒ NO

11(b) PARTICIPATION %: n/a

11(c) BONDED? ☐ YES ☐ NO n/a

12 IS CONTRACT SBA 8(a)? ☐ YES ☒ NO

13(a) DOES CONTRACTOR REQUIRE FINANCIAL/MNGMNT/TECH ASSISTANCE? ☐ YES ☒ NO

13(b) IF YES WHAT TYPE? n/a

14 REMARKS/CONCLUSIONS: GIA signed corporately and personally

15 CONTINUATION SHEET ATTACHED — CHECK (✓):

16 SBA FORM 990 (Guarantee Agreement) ATTACHED — CHECK (✓): XX

Items 17-35 are to be completed only on the initial submission and its Annual Up-Date

17 TYPE AND AMOUNT OF CONTRACTUAL WORK THIS CONTRACTOR HAS DONE PREVIOUSLY:

18(a) LARGEST PREVIOUS CONTRACT: $

18(b) LARGEST PREVIOUS WORK PROGRAM: $

19(a) ANY DISPUTES? ☐ YES ☐ NO

19(b) ON SCHEDULE? ☐ YES ☐ NO

20(a) HAS CONTRACTOR EVER FAILED TO COMPLETE JOB? ☐ YES ☐ NO

20(b) DETAILS:

21 WHAT IS EXPERIENCE(S) OF OFFICERS AND/OR OWNERS?

22(a) CONTRACTOR HAVE ADEQUATE EQUIP? ☐ YES ☐ NO

22(b) OWNED? ☐ YES ☐ NO

22(c) LEASED? ☐ YES ☐ NO

23 CONTRACTOR'S TAXES CURRENT? ☐ YES ☐ NO

24 CONTRACTOR INSURANCE COVERAGE SUFFICIENT? ☐ YES ☐ NO

25(a) SURETY RECEIVED COPY OF CURRENT FINANCIAL STATEMENT? ☐ YES ☐ NO

25(b) DATE OF FINANCIAL STATEMENT:

25(c) PREPARED BY WHOM?

25(d) FINANCIAL STATEMENT SHOW DISCLAIMER? ☐ YES ☐ NO

25(e) TYPE OF FINANCIAL STATEMENT: ☐ CASH ☐ SIMPLE ACCRUAL ☐ COMPLETED CONTRACT ☐ % COMPLETION

25(f) NET WORTH: $ 272,215.

25(g) WC: $105,000.

25(h) SURETY VERIFIED BANK BALANCE? ☐ YES ☐ NO

25(i) AVG BANK BALANCE: $

SBA Form 994B (2-73) REF SOP 50 45 PREVIOUS EDITIONS ARE OBSOLETE

SMALL BUSINESS ADMINISTRATION

## GUARANTEE AGREEMENT UNDER TITLE IV, PART B, OF THE SMALL BUSINESS INVESTMENT ACT OF 1958, AS AMENDED

SBG # 10330-02

This agreement, made and entered into this twenty ninth day of April , 19 76,

by and between the Small Business Administration, an agency of the United States Government, hereinafter referred as SBA and

International Fidelity Insurance Company , hereinafter referred to as Surety,

relative to Richard E. Wilson d/b/a Wilson Iron Works hereinafter referred to as Principal,

who has applied for bonds required for repair to the Powder Point Bridge in Duxbury,
(describe project)
for the Town of Duxbury, Mass.

WITNESSETH: That in consideration of the mutual convenants and agreements herein contained, the parties agree as follows:

1. Surety agrees, conditional on the execution of this guarantee by SBA, to become surety on the bid bond and if Principal's bid price is in line with other bidders in Surety's opinion and the contract price does not exceed $500,000, to become surety on performance, payment, maintenance, or any other bonds necessary or incidental to the performance of the above described contract executed on behalf of the Principal. The agreement in this paragraph shall not apply unless all prescribed underwriting conditions are met, nor shall it apply if subsequent or additional information comes to the attention of the Surety of a nature to change its underwriting decision as to the desirability of executing any of the aforementioned bonds.

2. Surety represents that such bond or bonds when executed by it as to terms and conditions will be in accord with those executed by professional sureties for the type of contract for which such bond or bonds are required to be furnished by Principal.

3. Surety affirms that without this SBA guarantee to Surety it will not issue any of said bonds to Principal.

4. SBA hereby agrees to guarantee to Surety 90% of any "loss" Surety may sustain or incur in good faith by reason of its execution of the bid, payment or performance bond contemplated by this Agreement.

5. SBA agrees that the term "loss" as used in this Agreement shall mean any and all liability, damages, court costs, counsel fees, charges and expenses of whatever kind or nature which the Surety shall or may, at any time, sustain or incur by reason, or in consequence, of having executed the bond or bonds herein guaranteed by SBA.

6. The Surety shall be entitled to credit for any and all disbursements, in and about the matters herein contemplated, made by it in good faith under the belief that it is or was liable for the sums and amounts so disbursed, or that it was necessary or expedient to make such disbursement (including efforts to diminish "loss"), whether such liability, necessity or expediency existed or not, and vouchers or other evidence of such disbursement shall be taken as prima facie evidence against SBA of the fact and extent of SBA's liability to Surety.

7. SBA agrees that Surety shall be entitled to reimbursement on a calendar quarterly basis under this guarantee for its loss, adjusted pro rata for any payments received by Surety from any other source.

8. Surety agrees that if any suit or claim is brought or instituted against Surety upon said bond or bonds, Surety shall inform SBA of the same within a reasonable time of receipt of the summons and complaint or claim in the Surety's home office. Unless otherwise agreed Surety shall take charge of all claim matters arising under said bonds, determine its liability and the amount thereof; compromise, settle or defend any claim or suit; and, take such action as it deems necessary to minimize loss.

9. Subsequent to the signing of the contract by the parties obligated thereon and the execution of the bonds guaranteed herein, no act or omission of the Surety in modifying, amending, limiting or extending any instrument executed by the Surety, nor the execution of any consent to the contract or bond(s) herein referred to, shall in anywise affect the liability of SBA hereunder, nor shall SBA be released from this obligation by reason thereof; and it is further agreed that Surety may thereafter alter, change, modify, amend, limit or extend any instrument or may execute renewal thereof, or other and new obligations in its place or in lieu thereof without notice to SBA, and in such case SBA shall be liable to Surety as fully and to the same extent on account of any such altered, changed, modified, amended, limited or extended instrument or such renewals thereof, or other or new obligations in its place or in lieu thereof, as fully as if such instrument were described at length herein.

10. Surety agrees to pay SBA 10% of its bond(s) premium for and in consideration of SBA's agreement to guarantee the bid, payment or performance bond contemplated by this Agreement. It is further agreed by SBA and Surety that Surety will pay SBA an additional like percentage of the additional premiums collected on any increase in contract price and SBA will make a like percentage refund on any premium reductions resulting from a reduction in the contract price. Where SBA or Surety's share of any additional premium increase or decrease is Five Dollars ($5.00) or less, there shall be no adjustment.

NOTICE - This Agreement is amended by Amendment 3 to 13 CF
Part 115 (FR 16549-50 published April 20, 1976 a
effective April 21, 1976)

IN WITNESS WHEREOF, the parties have caused this Agreement to be executed the date and year first above written.

International Fidelity Ins. Co.
SURETY

By Norman E Daniel
Norman E. Daniel, Attorney-in-Fact

SMALL BUSINESS ADMINISTRATION

By Leonard E. Chadwick
LEONARD E. CHADWICK
Assistant Regional Director for
Finance & Investment

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Amount of Contract $ $208,470.
Date 4/29/76

Bond Amount: Bid ________ Performance $208,470. Payment $208,470.
Date 4/29/76
Premium Charged (and % Rate) $1564. ($7.50 per thousand)
Scheduled Contract Completion Date six weeks from commencement

JACE
INDUSTRIES, INC.
333 NORTH BROADWAY JERICHO, N.Y. 11753
(516) 433-8059

March 7, 1977

Kimmelman, Lieb, Wolff, & Samson
80 Main Street
West Orange, NJ 07052

Attention: Mr. Samson

Re: REPAIR OF POWDER POINT BRIDGE, DUXBURY, MA

Dear Mr. Samson:

We hereby submit our quotation to complete the work of repairing the Powder Point Bridge in Duxbury, MA. We have based our quotation on visits to the job site and on the list of work to be completed as submitted in the letter of December 16, 1976 by Ms. Irene King, Secretary, Town of Duxbury, MA. The price for completing this work will be $130,000.

We also submit our quotation for the price of $5,000 in addition to the above figure for engineering and other work required to expidite payment to the bonding company of requisition, preparation of, reports in connection with a proposed claim against the Town for overpayment of Wilson Iron Works, and other engineering, technical, and administrative work that may be required to bring this contract to a successful conclusion. We are submitting to you under separate cover a breakdown of unit prices to be used for partial payment purposes. Please expidite our contract as we expect to start work on this project on or about March 21.

May we bring to your attention the specification requirement that the Town will provide partial payment requisitions every two weeks. We also will submit to you our requisition for payment with a copy of the Town's approved requisition every two weeks for payment.

Very truly yours,

Calvin Zemsky, P.E.

CZ:tk

March 11, 1977

Mr. Calvin Zemsky, P.E.
Jace Industries, Inc.
333 North Broadway
Jericho, New York 11753

Re: IFIC - Wilson Iron Works
Powder Point Bridge, Duxbury, Ma.

Dear Mr. Zemsky:

In relation to your quote of March 7, please be advised that the surety has accepted same and that a takeover agreement will be prepared by Joseph Steinfield, Esq. of the firm of Hill and Barlow in Boston. Please contact Mr. Steinfield for execution of the agreement.

With respect to your engineering work, the surety has also accepted same with the understanding that you will serve as a management consultant on this project and will aid the surety in preparing a claim against the Town and/or its architects for overpayment to the contractor.

Very truly yours,

DAVID SAMSON

DS:jet

cc: Joseph Steinfield, Esq.
Mr. Fred Mitterhoff

HILL
&
BARLOW

223 FRANKLIN STREET
BOSTON · MASSACHUSETTS 02110
TELEPHONE (617) 423-6200 CABLE BLACKACRE, BOSTON
TELEX 94-0916

March 16, 1977

Mr. Calvin Zomsky, P.E.
Jaco Industries, Inc.
333 North Broadway
Jericho, New York 11753

Re: Repair of Powder Point Bridge, Duxbury

Dear Mr. Zomsky:

I am enclosing four copies of a revised contract on the above matter. The revisions were made after a discussion with Mr. David Samson.

If you will sign and return three copies to me, I will obtain the signatures of the other parties.

Very truly yours,

Thomas G. Taylor

TGT:pjk
Enclosures

cc: David Samson, Esquire
(with enclosure)

## AGREEMENT

0-30

This Agreement entered into this 22nd day
of March, 1977 by and between:

INTERNATIONAL FIDELITY INSURANCE COMPANY,
having its office located at 24 Commerce
Street, Newark, New Jersey, 07102,
hereinafter referred to as "SURETY",

AND

JACE INDUSTRIES, INC., having its office
at 333 North Broadway, Jericho, New York
11753, hereinafter referred to as "CONTRACTOR";

WITNESSETH

WHEREAS, International Fidelity Insurance Company has executed, as surety, performance-payment bond #022752 dated May 7, 1976, on behalf of Richard E. Wilson, Sr. d/b/a Wilson Iron Works and in favor of the Town of Duxbury, Massachusetts; and

WHEREAS, said surety bond referred to a certain construction contract between said Richard E. Wilson, Sr. d/b/a and said Town of Duxbury dated May 17, 1976, whereunder said Richard E. Wilson, Sr. agreed to perform repairs to the Power Point Bridge in the Town of Duxbury in accordance with the Contract Documents as defined in said construction contract, which Contract Documents were prepared by Geotechnical Consultants, Inc.

WHEREAS, the said Town of Duxbury has terminated said Richard E. Wilson, Sr. from the said construction project by reason of the failure of Richard E. Wilson, Sr. to complete performance of the aforesaid construction contract; and

WHEREAS, International Fidelity Insurance Company desires to complete the said project in accordance with the aforesaid construction contract and to have its surety bond duly released by the Town of Duxbury;

NOW, THEREFORE, the parties hereto agree as follows:

1. The Contractor shall provide all materials and perform all work necessary for the completion of the general construction contract previously entered into between the Town of Duxbury and Richard E. Wilson, Sr., all of which uncompleted work is set forth in a letter to David Samson from Irene H. King, Secretary of the Board of Selectmen dated December 16, 1976, a copy of said letter being annexed hereto as Exhibit A.

2. The Surety shall pay the Contractor for the performance of the work the sum of $130,000.00. In the event additional work is required to be corrected or repaired at the direction of the Town of Duxbury, the Contractor shall complete same at an agreed price or at its cost plus ten percent (10%) for overhead and profit. Based upon applications for payment submitted bi-weekly by the Contractor and approved by Geotechnical Consultants, Inc. and certified by them that all work has been done in accordance with the Contract Documents, the Surety shall make progress payments

on account of the aforesaid sum to the Contractor on the thirtieth day following approval by Geotechnical Consultants, Inc., such payments to be for that work completed. The final payment shall be paid by the Surety to the Contractor thirty (30) days after completion of the work and final approval and acceptance thereof by the Town of Duxbury.

3. The Contractor shall commence work no later than March 21, 1977 and shall proceed with said expeditiously with adequate men and materials. All work shall be completed not later than May 23, 1977.

4. At the time of execution of this Contract, the Contractor shall furnish to the Surety a performance bond and a payment bond each in the amount of the contract, in the usual form, naming International Fidelity Insurance Company and the Town of Duxbury as obligees, covering the faithful performance of this Contract and the payment of all obligations arising thereunder. In addition, the Contractor shall perform and complete all of the aforesaid work in accordance with all applicable laws, rules and regulations. Further, the Contractor shall, at its cost, procure and maintain insurance required under the Workmen's Compensation Law, as well as full Public Liability Insurance in such form and coverage as shall be satisfactory to the Surety, and the Contractor shall hold harmless the Surety from any damages, liability or claims in connection with the said work.

5. Should any dispute arise with respect to the true construction or meaning of the plans referred to hereinabove or to the scope of the work to be performed hereunder, the same shall be determined by Geotechnical Consultants, Inc., whose decision shall be binding on all parties.

6. This contract shall be subject to the approval of the Town of Duxbury and all work shall be performed by the Contractor under the supervision and subject to the approval of Geotechnical Consultants, Inc. Upon the completion of said work, the Town of Duxbury shall release the bond #022752 and return it to Surety.

IN WITNESS WHEREOF, the parties hereto have respectively set their hands and seals, all as of the day and year first above written.

ATTEST:

________________________

INTERNATIONAL FIDELITY INSURANCE
COMPANY

By________________________
Francis L. Mitterhoff - Secy.

WITNESS:

________________________

________________________

JACE INDUSTRIES, INC.

By________________________
Secretary/Treasurer

ATTEST:

________________________

TOWN OF DUXBURY

BY________________________

________________________

________________________

________________________

________________________

C 1-02-541390

[illegible]

7-6-77

# RESOLUTION FOR CORPORATE ACCOUNT

I, the undersigned, Secretary of Bobcris Cont. Corp.

corporation having its principal place of business at P.O. Box 180, Westbury, NY 11590 HEREBY CERTIFY that at a meeting of the Board of Directors of said corporation, duly held on the 25th day of May, 1977, a quorum being present, the following resolutions were unanimously adopted and recorded in the minute books of said corporation, kept by me, and are in accord with and pursuant to the charter and by-laws of said corporation, and are now in full force and effect, to wit:

RESOLVED, that

1. LONG ISLAND NATIONAL BANK (hereinafter referred to as Bank) be and hereby is designated as a depository of this corporation, and it is hereby authorized to pay, cash or otherwise honor and charge to this corporation any and all checks, notes, drafts, bills of exchange, acceptances, orders or other instruments for the payment of money or the withdrawal of funds, when signed, made, drawn, accepted or indorsed on behalf or in the name of this corporation by any person then holding any of the following offices or by any of the following named signatories, without counter-signature or co-signature except to the extent indicated as follows: Two signatures/Secretary & President

2. Said Bank is further authorized to pay, cash or otherwise honor and charge to this corporation any such instrument without regard to any notation on any part thereof indicating the effect, purpose or condition of its issuance, delivery, receipt or acceptance, and without regard to any alteration, defacement or erasure of such notation, and said Bank is expressly relieved of any duty on its part to pass upon the regularity of such notation, or to make any inquiry in respect thereof or in respect of any alteration, defacement or erasure thereof. Said Bank may conclusively assume that the date of any such instrument, acceptance or indorsement is the true date of the making, drawing, acceptance or indorsement, as the case may be, completed in each instance by delivery on that date.

3. Said Bank is hereby authorized to pay, cash or otherwise honor and charge to this corporation any such instrument and any instrument payable to or held by this corporation when indorsed as aforesaid, and also to receive same for credit to the account of or in payment from the payee, indorsee or any other holder thereof, including any officer, agent or signatory of this corporation, without limitation of amount and without inquiry as to the circumstances of issue, negotiation or indorsement thereof or as to the disposition of the proceeds thereof, even if drawn, indorsed or payable to cash, bearer or to the individual order of any signing officer, agent or signatory, or tendered in payment of his individual obligation.

4. Indorsements on behalf of this corporation upon any and all commercial paper of any kind deposited by or on behalf of this corporation with the said Bank for credit or for collection or otherwise, may be made, affixed or imprinted (manually or by stamp impression) by any one of the foregoing officers or signatories or by any other person authorized or purporting to be authorized so to do, and in any case the indorsement may bear the name of this corporation alone without specifying the person who made, affixed or imprinted the same or his authority so to do.

5. Any one of the foregoing officers of this corporation is hereby authorized to borrow money and to obtain credit for this corporation from said Bank on such terms as may seem to him advisable, and to deliver notes, drafts, acceptances, agreements and any other obligations of this corporation therefor in form satisfactory to said Bank, signed as designated in paragraph 1 above, and as security therefor to assign, transfer, hypothecate, mortgage, pledge, trustee, withdraw, exchange and substitute any stocks, bonds, securities, bills and accounts receivable, bills of lading, warehouse receipts or any other property of this corporation, with full authority to indorse or guarantee the same in the name of this corporation, to execute and deliver all instruments of assignment, transfer, hypothecation, mortgage, pledge and trust, and to affix the corporate seal. Any one of the officers or any one of the aforementioned signatories of this corporation acting alone is hereby authorized to discount any bills receivable or paper of any kind (negotiable or otherwise) with full authority to indorse the same in the name of this corporation.

6. All the foregoing authorities shall continue in full force and effect until revoked or modified by written notice actually received by said Bank at its office where the account is maintained, setting forth a resolution to that effect stated to have been adopted by the Board of Directors of this corporation, and signed by one purporting to be the secretary or an assistant secretary of this corporation and bearing the purported seal of this corporation; and said Bank is hereby authorized at all times to rely upon the last notice, certificate or communication received by it, when so authenticated, as to any resolution of this corporation, or as to the persons who from time to time may be officers or signatories of this corporation, or as to their respective signatures and/or as to any other corporate matters, and Bank shall be harmless in such reliance.

7. The secretary (or any assistant secretary) of this corporation is hereby authorized to certify and deliver to said Bank copies of these resolutions, and the signatures of the president (or any vice-president) and the secretary (or any assistant secretary) of this corporation at the foot of the certificate containing these resolutions shall constitute such certificate and resolutions and agreement by this corporation with said Bank with respect to all matters set forth in said certificate and resolutions.

I FURTHER CERTIFY that the persons herein designated as officers of this corporation have been duly elected to and now hold the offices in this corporation set opposite their respective names, and that the following are the authentic, official signatures of the said respective officers and of the named signatories who are not corporate officers, to wit:

| | | |
|---|---|---|
| Eilene Mazzola<br>Name (Print or Type) | Eileen Mazzola<br>(Signature) | President |
| Name (Print or Type) | (Signature) | Vice-President |
| Sheila Schmuger<br>Name (Print or Type) | Sheila Schmuger<br>(Signature) | Secretary |
| Name (Print or Type) | (Signature) | Treasurer |
| Name (Print or Type) | (Signature) | |

IN WITNESS WHEREOF, I have hereunto subscribed my name and affixed the seal of this corporation by order of the Board of Directors this 25th day of May , 1977

AFFIX SEAL BELOW

Sheila Schmuger Secretary

I, the undersigned, President of the corporation above named, do hereby certify that the foregoing certificate is in all respects true and contains a true copy of the resolutions regularly adopted by the Board of Directors of said corporation in the manner therein stated.

Eileen Mazzola
President

0-1
47

Bradstreet Inc.

SURE NAME, BUSINESS AND
ESS MATCH YOUR FILE.

LATER REPORT
WILL FOLLOW

This report has been prepared for
SUBSCRIBER: 004-00536

00001007

CONSOLIDATED REPORT (FULL REVISION)

DUNS: 09-236-4207
JACE INDUSTRIES INC

137 FLORIDA ST
FARMINGDALE NY 11735
TEL: 516 454-6720

DATE PRINTED
SEP 30 1980

GEN CONTR
SIC NO.
15 41

SUMMARY 1-45.
RATING ER8
(NOT LISTED IN PUBLICATION)
STARTED 1976
PAYMENTS SEE BELOW
EMPLOYS 2
HISTORY INCOMPLETE

CHIEF EXECUTIVE: JOSEPH BERGIANTI, PRES

SPECIAL EVENTS

07/03/80 Subject moved to caption address.

10/31/79 Corporation moved to 137 Florida St, Farmingdale, NY in 1979.

FINANCE

10/31/79 On Zemsky, mgr, declined all information.

PUBLIC FILINGS

10/31/79 On Oct 4, 1978, a suit in the amount of $81,780 was entered against Jace Industries Inc by Larry La Calandra. Cause of action was note or notes.

07/29/80 On Jun 30, 1980, a judgement was entered in the amount of $5,449 against Jace Industries Inc in favor of Abraham Papish.

On Jun 19, 1980, a judgement was entered in the amount of $2,967 against Jace Industries Inc in favor of Industrial Comm.

07/03/80 On Jun 27, 1980, a judgement was entered in the amount of $2,049 against Jace Industries Inc in favor of Larry Lacalandra dba Larry's Brick Co.

06/27/80 On Apr 28, 1980, a judgement was entered in the amount of $6,53[illegible] against Jace Industries in favor of Lindenhurst Fabricators.

10/31/79 On Apr 6 1979, a financing statement ($46,811) was filed listing Jace Inoustries Inc as debtor and Shirley Papish, Westbury, NY as secured party. Collateral consists of all presently owned and hereafter acquired accounts receivable, accounts, contract rights, chattel paper, inventory, equipment, office equipment, fixtures, office furniture and substitutions or replacements thereof. Products of the collateral are also covered.

10/31/79 Current status of above not known.

HISTORY

10/31/79

JOSEPH BERGIANTI, PRES
DIRECTOR: THE OFFICER.

Incorporated NY Apr 10, 1976. Authorized capital consists of 200 shares common stock, no par value.

Antecedents not available. Stock ownership declined.

Moved here from 333 No Bdwy, Jericho, NY in 1979.

OPERATION

10/31/79 General contractors doing commercial work. Terms are generally contract basis with progress payment and payment upon completion. Sells to individuals and commercial concerns. Territory Metropolitan NY. Season peaks March-Oct. Business slow Nov-Feb. Subcontracts all work.

EMPLOYEES: 2 including officers.

FACILITIES: Rents 800 sq. ft. on 3rd floor of multi story brick cement block building in good condition.

LOCATION: Central business section on main street.

09-30(000 /5 )0000/00 00000 021

IS REPORT, FURNISHED PURSUANT TO CONTRACT FOR THE EXCLUSIVE USE OF THE SUBSCRIBER AS ONE FACTOR TO CONSIDER IN CONNECTION WITH CREDIT, SURANCE, MARKETING OR OTHER BUSINESS DECISIONS, CONTAINS INFORMATION COMPILED FROM SOURCES WHICH DUN & BRADSTREET, INC. DOES NOT CONTROL AND HOSE INFORMATION, UNLESS OTHERWISE INDICATED IN THE REPORT, HAS NOT BEEN VERIFIED. IN FURNISHING THIS REPORT, DUN & BRADSTREET, INC. IN NO WAY SUMES ANY PART OF THE USER'S BUSINESS RISK, DOES NOT GUARANTEE THE ACCURACY, COMPLETENESS, OR TIMELINESS OF THE INFORMATION PROVIDED, AND IALL NOT BE LIABLE FOR ANY LOSS OR INJURY WHATEVER RESULTING FROM CONTINGENCIES BEYOND ITS CONTROL OR FROM NEGLIGENCE. 9R2-10 (780128)

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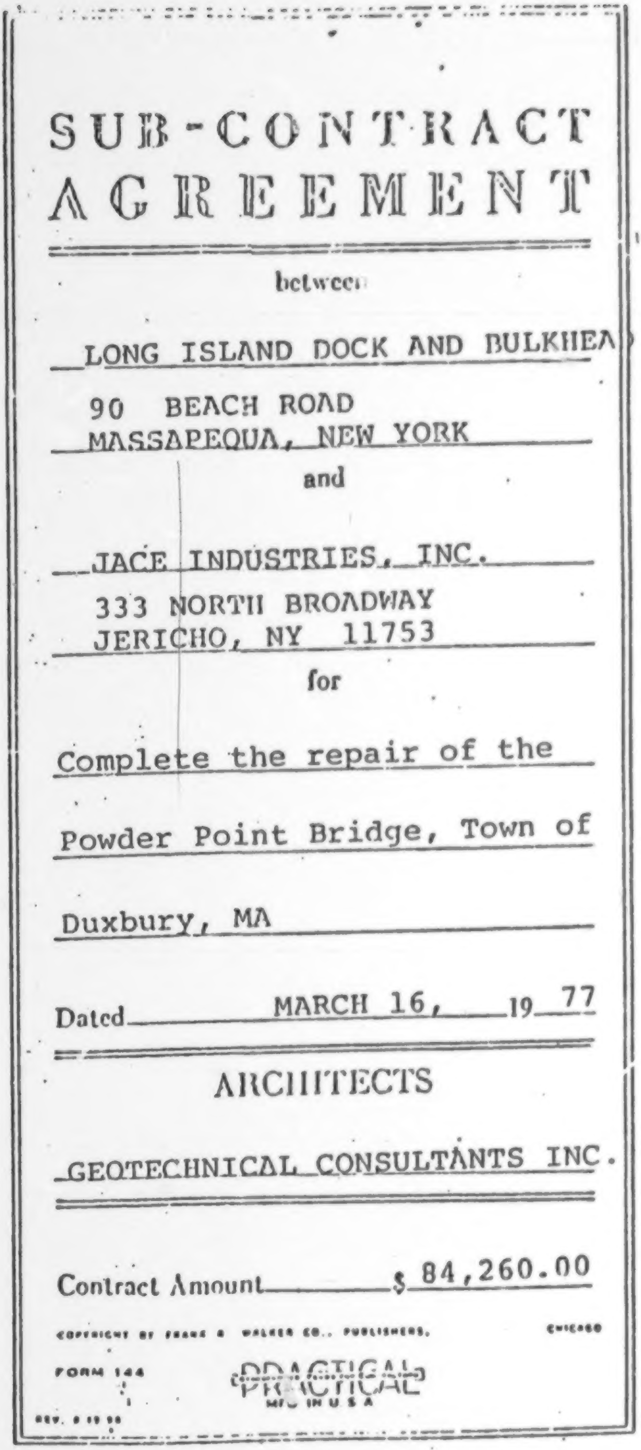

# SUB-CONTRACT AGREEMENT

between

LONG ISLAND DOCK AND BULKHEA

90 BEACH ROAD
MASSAPEQUA, NEW YORK

and

JACE INDUSTRIES, INC.

333 NORTH BROADWAY
JERICHO, NY 11753

for

Complete the repair of the Powder Point Bridge, Town of Duxbury, MA

Dated MARCH 16, 19 77

ARCHITECTS

GEOTECHNICAL CONSULTANTS INC.

Contract Amount $ 84,260.00

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FORM 144

PRACTICAL
MFG IN U.S.A

REV. 8 19 [illegible]

# Sub-Contract Agreement

THIS AGREEMENT, made this SIXTEENTH day of MARCH A. D. 1977,
by and between L. I. DOCK & BULKHEAD CORP.
hereinafter called the Sub-contractor and JACE INDUSTRIES, INC. & INTERNATIONAL
FIDELITY INSURANCE CORP. hereinafter called the Contractor.

For the consideration hereinafter named, the Sub-contractor covenants and agrees with the said Contractor as follows:

First. The Sub-contractor will furnish all materials and labor, including all necessary scaffolding, and fully construct and in a good substantial, thorough and workmanlike manner perform and in every respect complete

Work to consist of completing those items and outlines in the statement of remaining work submitted by the Town of Duxbury, MA in their letter of December 16, 1976 referred to as Job #752608.

Unit prices will be as per attached list, quantityes as per certified by the Town of Duxbury representative or engineer.

Increase or decrease of quantities or extra work will be as substantiated by the Town engineer or representative at prices herein agreed upon or to be agreed upon in the future.

for the above named structure, according to the plans and specifications (details thereof to be furnished as needed) of GEOTECHNICAL CONSULTANTS, INC., Architect, and to the full satisfaction of said Architect.
ONE RICHARDSON LANE, STONEHAM, MA 02180

Second. The Sub-contractor will promptly begin said work as soon as he is notified by the Contractor that the ground is clear or the structure far enough advanced to allow the beginning of that portion included hereunder, and will carry forward and complete said work as rapidly as said Contractor may judge that the progress of the structure will permit, unless detained by other Sub-contractors; in which event he will promptly notify the Contractor in writing, who (if satisfied that said delay is caused by others than said Sub-contractor hereunder) will allow additional time sufficient in his judgment to make up the time so lost. This paragraph shall cover any extra work done or materials furnished under this contract.

Third. The Sub-contractor will furnish said materials, including all necessary scaffolding, and prosecute said work with due diligence, without delay, and shall not in any manner, by delay or otherwise, interfere with the work of the Contractor, or other Sub-contractors, and should the said Contractor conclude that the said Sub-contractor is delaying said work, he shall so notify said Sub-contractor, who shall, within THREE days thereafter, furnish whatever materials are required by said Contractor, and employ additional men, as required by said Contractor, and in case said Sub-contractor fails to comply with said demand, the said Contractor shall have the right to furnish said materials and employ said additional men and charge the expense thereof against the said Sub-contractor and deduct same from this contract, and should the amount or balance due on said contract be insufficient, to collect said deficiency by legal process.

FOURTH. Should said Sub-contractor fail to begin, continue and complete the work as hereinbefore provided and should the Contractor suffer or permit said Sub-contractor to occupy more time than is required under this agreement, in that event the said Sub-contractor hereby covenants and agrees to indemnify and save harmless the said Contractor from any loss or damages which he may be compelled to make good to the owner of said building under or by virtue of the contract with the owner, for or on account of delay in the completion thereof, insofar as said delay was caused by the said Sub-contractor.

FIFTH. The Sub-contractor shall provide sufficient, safe and proper facilities at all times for the inspection of the work by the Architect, the Contractor or his authorized representatives. He shall, at once, remove all materials and take down and rebuild all portions of the work condemned by the Architect or Contractor, upon receiving notice in writing of such condemnation.

SIXTH. The Sub-contractor shall not employ any workmen whose employment on the building or improvement may be objected to by any of the other Sub-contractors, the Contractor, the Architect, or the Owner.

SEVENTH. No extra work or changes under this contract will be recognized or paid for, unless agreed to in writing before the work is done or the changes made, in which writing shall be specified in detail the extra work or changes desired, the price to be paid or the amount to be deducted, should said changes decrease the amount to be paid hereunder.

EIGHTH. The Sub-contractor hereby covenants and agrees to indemnify and save harmless the Contractor from any and all manner of claims or suits for infringements of patents or violation of patent rights, including all costs and expenses to which the Contractor may be put in defending any actions that may arise under this clause of the contract.

NINTH. The Sub-contractor agrees to indemnify and save harmless the Owner and General Contractor against loss or expense by reason of the liability imposed by law upon the Owner or General Contractor for damage because of bodily injuries, including death at any time resulting therefrom; accidentally sustained by any person or persons or on account of damage to property arising out of or on account of or in consequence of the performance of this contract, whether or not such injuries to persons or damage to the property are due or claimed to be due to any negligence of the Sub-contractor, his employees, his agents or servants.

TENTH. The Sub-contractor shall protect and indemnify said Contractor against any loss or damage suffered by any one arising through the negligence of the Sub-contractor, or those employed by him or his agent or servants; he shall bear any expense which the Contractor may have by reason thereof, or on account of being charged therewith; and if there are any such injuries to persons or property unsettled for, when the work herein provided for is finished, final settlement between the Contractor and Sub-contractor shall be deferred until such claims are adjusted or suitable special indemnity acceptable to the Contractor is provided by the Sub-contractor.

ELEVENTH. The Sub-contractor shall take out and pay for Employers' Liability or Workmen's Compensation insurance as required by the State in which this work is performed, also Public Liability and Property Damage insurance, in amounts to be agreed upon by the Contracting parties. Upon signature of this contract the Sub-contractor must submit certificate of insurance to include Owners' or Contractors' Protective Liability.

TWELFTH. The Sub-contractor shall pay all Sales Taxes Use Taxes, Excise Taxe Old Age Benefit and Unemployment Compensation Taxes upon the material and labor furnished under this contract, as required by the Statutes of the United States Government and the State in which this work is performed.

THIRTEENTH. This contract shall not be assigned by the Sub-contractor. Any attempt to assign the contract shall operate as an instant forfeiture and repudiation thereof by the Sub-contractor and the rights of the parties shall be determined in the same manner as though the Sub-contractor had at the time of such attempted assignment failed and refused to continue to perform the contract.

FOURTEENTH. It is expressly UNDERSTOOD AND AGREED by and between the parties hereto that time is and shall be considered the essence of the contract on the part of the said Sub-contractor, and in the event that the said Sub-contractor shall fail in the performance of the entire work to be performed under this contract, by and at the time or times herein mentioned or referred to, the said Sub-contractor shall pay unto the said Contractor, as and for liquidated damages, and not as a penalty, the sum of FIFTY DOLLARS (\$50.00) PER DAY Dollars per day, which said sum of \$________ per day, in view of the difficulty of estimating such damages with exactness, is hereby expressed, fixed, computed, determined and agreed upon as the damages which will be suffered by the Contractor by reason of such default; and it is understood and agreed by the parties of this contract that the liquidated damages hereinbefore mentioned are in lieu of the actual damages arising from such breach of this Contract, which said sum the said Contractor shall have the right to deduct from any moneys otherwise due or to become due to the said Sub-contractor, or to sue for and recover compensation or damages for the non-performance of this contract at the time or times herein stipulated or provided for.

The Sub-contractor knows that the Contractor must have his contract performed on or before the TWENTY-[illegible] day of MAY ; and it is therefore understood and agreed that the work provided for herein shall be entirely completed on or before ............ and to that end the Sub-contractor will perform not less than the following average amount of work: ............

No allowance for time will be made Sub-contractor for delay in preparing his drawings or in securing approval of Architect hereto when such drawings are not properly prepared for approval of Architect.

When extension of time for strikes or fire casualties has been granted Contractor by Architect or Owner, the same extension will be granted said Sub-contractor.

**Fifteenth.** The Sub-contractor further agrees that he will within ten days from date provide the Contractor with a bond in the sum of $ 90,000 conditioned for the faithful performance of this contract in all its particulars, duly executed with Surety company acceptable to the Contractor, as surety, and in the form and contents acceptable to the Contractor.

IN CONSIDERATION WHEREOF, the said Contractor agrees that he will pay to the said Sub-contractor, in monthly payments, the sum of APPROXIMATELY $84,260.00 for said materials and work, said amount to be paid as follows: NINETY per cent. ( 90 %) of all labor and material which has been placed in position and for which payment has been made by said "Owner" to said Contractor, to be paid on or about the SEE ADDENDY #2 of the following month, except the last payment, which the said Contractor shall pay to said Sub-contractor immediately after said materials and labor installed by said Sub-contractor have been completed, approved by the said Architect, and final payment received by the Contractor and satisfactory evidence furnished to Contractor by Sub-contractor that all labor and material accounts for use on this particular work have been paid in full.

It is further understood and agreed that no payment on account shall operate as an approval of said work or materials, or any part thereof.

All negotiations and agreements prior to the date of this memorandum are merged herein. We have read and fully understand this agreement.

The Contractor and the Sub-contractor for themselves, their successors, executors, administrators and assigns, hereby agree to the full performance of the covenants of this agreement.

IN WITNESS WHEREOF, they have executed this agreement the day and date written above.

Witness:

L.I. DOCK & BULKHEAD CORP.
Sub-Contractor.

Robert
By

JACE INDUSTRIES, INC.
Contractor.

By

JACE
INDUSTRIES, INC.
[illegible] NORTH BROADWAY JERICHO, N.Y. 11753
(516) 433-6059

March 16, 1977

L.I. Doc & Bulkhead Corp.
90 Beach Road
Massapequa, New York

Attention: Mr. Bob Ellerman

**AMENDMENT #1**

Re: POWDER POINT BRIDGE
BREAKDOWN OF PRICES

| ITEM | DESCRIPTION | WORK REMAINING | UNIT PRICE | TOTAL |
|---|---|---|---|---|
| II | Timber Piles New | 242 L.F. | 10 MBFM | $ 2,420 |
| IV | Timber Removed | 15 MBFM | 200MBFM | 3,000 |
| V | Pile to Pile Cap. Conn | 128 EA | 225 EA | 28,800 |
| VI | Cross Bracing New | 3 MBFM | 3000MBFM | 9,000 |
| VII | Cross Bracing Reset | 1 MBFM | 3000MBFM | 3,000 |
| X | Pile Cap New Side Rail | 0.23MBFM | 3700MBFM | 851 |
| XIIA | Stringers New | 0.78MBFM | 3700MBFM | 2,886 |
| XIIB | Stringers Reused | 4 MBFM | 500 MBFM | 2,000 |
| XIIIA | Decking New (nailing only) | | L.S. | 2,352 |
| XIIIB | Decking Reused | 18 MBFM | 300 MBFM | 5,400 |
| XIVA | Curbing New | 6 MBFM | 550 MBFM | 3,300 |
| XIVB | Curbing Reused | 11 MBFM | 54 MBFM | 594 |
| XVA | Railings New | 7.7 MBFM | 475 MBFM | 3,657 |
| XVA | Railings Reset | 500 L.F. | 4 MBFM | 2,000 |
| | Mobilization | L.S. | | 15,000 |
| | | | | $84,260 |

**EXTRAS**

| ITEM | DESCRIPTION | WORK REMAINING | UNIT PRICE | TOTAL |
|---|---|---|---|---|
| XIIIA1 | Extra Decking New Material and Labor | 2 MBFM | 3700BFM | 7,400 |
| XVI | Pile Cutoffs | 8 EA | 150 EA | 1,200 |

Very truly yours,

Calvin Zemsky, P.E.

CZ:tk

CZ Ch.

ADDENDA #2

PAYMENT TO BE MADE WITHIN 15 DAYS OF REQUISITION DATE WHICH WILL BE EVERY TWO WEEKS.

THE HARTFORD

Hartford [illegible] surance Company
Hartford [illegible] nt and Indemnity Company
5 Hartford Casualty Insurance Company
6 New [illegible] Underwriters Insurance Company
7 Twin [illegible] Fire Insurance Company

This is to certify that the company [illegible] the policies enumerated below.

Co. Code
5

Named Insured and Address

Long Island Dock & Bulkhead Corp.
90 Beach Street
Massapequa, N.Y. 11758

The policies indicated herein apply with respect to the hazards and for the coverages and limits of liability indicated by specific entry herein but this certificate of insurance does not amend, extend or otherwise alter the terms and conditions of the insurance coverage in the policies identified herein.

| Hazards | Policy Number and Policy Term | Coverages and Limits of Liability |  |  |  |  |  |
|---|---|---|---|---|---|---|---|
|  |  | (SINGLE LIMIT) |  | (DUAL LIMITS) |  |  |  |
|  |  | Bodily Injury and Property Damage Liability |  | Bodily Injury Liability |  | Property Damage Liability |  |
|  |  | each occurrence | aggregate | each occurrence | aggregate | each occurrence | aggregate |
| General Liability<br>Premises-Operations | 12 C 165690<br>12/19/76 - 77 | $ ,000 | $ ,000 | $ 500 ,000 | XXXX | $ 500 ,000 | $ 500 ,000 |
| Independent Contractors |  | $ ,000 | $ ,000 | $ ,000 | XXXX | $ ,000 | $ ,000 |
| Completed Operations; Products | Included | $ ,000 | $ ,000 | $ ,000 | $ ,000 | $ ,000 | $ ,000 |
| Contractual (as described below) |  | $ ,000 | $ ,000 | $ ,000 | XXXX | $ ,000 | $ ,000 |

| Hazards | Policy Number and Policy Term | Coverages and Limits of Liability |  |  |  |  |  |
|---|---|---|---|---|---|---|---|
|  |  | (SINGLE LIMIT) |  | (DUAL LIMITS) |  |  |  |
|  |  | Bodily Injury and Property Damage Liability |  | Bodily Injury Liability |  | Property Damage Liability |  |
|  |  | *each occurrence | aggregate | each person | *each occurrence | *each occurrence | aggregate |
| Automobile Liability<br>Owned Automobiles |  | $ ,000 | XXXX | $ ,000 | $ ,000 | $ ,000 | XXXX |
| Hired Automobiles |  | $ ,000 | XXXX | $ ,000 | $ ,000 | $ ,000 | XXXX |
| Non-Owned Automobiles |  | $ ,000 | XXXX | $ ,000 | $ ,000 | $ ,000 | XXXX |
| N.Y.Disability | DB 76310 |  |  |  |  |  |  |
| Workmen's Compensation and Employers' Liability | 12WE 953690<br>12/19/76-77 |  |  | Compensation — Statutory<br>N.Y.<br>Employers' Liability — $ 100 ,000 |  |  |  |
| Umbrella Liability |  |  |  | $ ,000,000 |  |  |  |

*If with respect to Automobile Liability the Policy Number entered above includes the symbol GB, AZ, MVP, MAG or PGB, the word "occurrence" is amended to read "accident".

Location and description of operations, automobiles, contracts, etc. (For contracts, indicate type of agreement, party and date.) / Duxbury, Mass.

If policy is canceled, 10 day written notice will be given to:

Jace Industries Inc. and International
Fideltiy Insurance Corp.
33 North Broadway
Jericho, N.Y. 11573

Date 4/1/77rb

By Luffig-Frank & Associates Inc.
*Authorized Representative*

Form [illegible] Printed in U.S.A.

## FACT SHEET

| | |
|---|---|
| Principal: | State Mechanical Construction Company, Inc.<br>Mt. Kisco, New York |
| Obligee: | City of Newburgh, New York |
| Surety Bond Guarantee Number: | 200-20181-003-30 |
| Surety: | International Fidelity Insurance<br>Newark, New Jersey |
| Underwriter: | V. David Levitt<br>Mt. Vernon, New York |
| Claims Adjuster: | David Samson of Kimmelman, Wolf & Samson<br>West Orange, New Jersey |
| Completion Contractor: | Progress Builders<br>Neptune, New Jersey |
| Cost of Original Contract: | $346,986 |
| Loss to SBA: | $190,289 |

## BACKGROUND

On May 16, 1974, SBA guaranteed a bond executed by IFI for State Mechanical Construction Company. The contract was with the City of Newburgh, New York and required the installation of heating, ventilating and air conditioning equipment in a Public Safety Building located in Newburgh.

The City declared State in default on January 12, 1976 due to the company's failure to pay suppliers and unsatisfactory progress on the project. The surety retained claims attorney David Samson to oversee completion of the job. Samson approved a $198,840 contract with Progress Builders on May 16, 1976 to complete the project. The contract was an oral agreement. Samson never formally executed a written contract. Progress completed the job in April 1978.

## FINDINGS

The SBA office of Inspector General conducted an audit of this claim. The IG's findings indicate that Jack Martin, President of State Mechanical, allegedly submitted fraudulent financial statements in connection with his application for bonding. Philip Skirloff the certified public accountant who purportedly prepared these statements has denied any involvement in their preparation.

Following the default by State, the surety's claims attorney contacted Progress Builders and requested they analyze the project and perform the work necessary to keep the project going. On May 19, 1976 Progress submitted a proposal to complete the project for $198,840.

Progress Builders is a general contracting firm located in Neptune, New Jersey. As a general contractor, Progress was unqualified to complete the mechanical work required by the contract. Dun & Bradstreet reported that Progress had between two and four employees and that the firm "contracted all work to others".

Progress subcontracted with Favino Mechanical Construction Co. to complete the majority of the remaining work on the project for approximately $64,000. Progress also made payments totaling $25,000 to Bevin Irvin Builders for work performed on the completion contract. Bevin Irvin Builders is owned by a brother of Progress' President. Gary Irvin, President of Progress, stated that these payments to his brother's company were for color coding oil lines and for supervisory duties.

Progress Builders essentially received in excess of $46,000 for acting as a broker on this completion contract.

The surety filed suit for recovery under the General Indemnity Agreement (GIA) executed by the principals of State, and recovered $50,000; however, the whereabouts of the two majority stockholders of State are unknown.

SMALL BUSINESS ADMINISTRATION

## APPLICATION FOR SURETY BOND GUARANTEE ASSISTANCE

NAME OF APPLICANT STATE MECHANICAL COMPANY, INC

APPLICANT'S HOME ADDRESS (Include ZIP)

APPLICANT'S BUSINESS ADDRESS (Include ZIP)
444 MAIN STREET
MOUNT KISCO, N.Y. 10549

NAME OF BROKER/AGENT V. David Levitt V. DAVID LEVITT

BROKER/AGENT'S ADDRESS (Include ZIP)
22 WEST 1ST STREET
MOUNT VERNON, N.Y. 10550

BROKER/AGENT'S TELEPHONE (Include Area Code) 914-664-3610

NAME OF SURETY IF KNOWN INTERNATIONAL FIDELITY INSURANCE COMPANY

1. Applicant hereby states and affirms the following:
   - a. The gross dollar volume of my business and affiliates (1) during the past fiscal year or (2) annually averaged over the past 3 fiscal years to the nearest hundreds was $ ______.
   - b. A bid, payment or performance bond is required on the following project or to serve as a primary contractor or subcontractor thereon.
   - c. Brief description of project including projected job completion date. THE PUBLIC SAFETY BUILDING IS FOR THE CITY OF NEW BURGH, NEW YORK FOR ALL CITY DEPARTMENTS. OUR WORK CONSISTS OF HEATING, VENTILATION AND AIR CONDITIONING WORK. PROJECTED JOB COMPLETION DATE IS APOX. BY SEPT. 1975.
   - d. Approximate value of contract: $ 343,553.00.
   - e. Applicant, in consideration of assistance from the Small Business Administration, herewith covenants, promises, agrees, and gives assurance that it will comply with the nondiscrimination requirements of Part 112 of the Regulations issued by the Small Business Administration (30 F.R. 298) pursuant to Section 602 of Title VI of the Civil Rights Act of 1964 (78 Stat. 252); and of Part 113 of the Regulations issued by the Small Business Administration (31 F.R. 2374) pursuant to Sections 4 and 5 of the Small Business Act (72, Stat. 384, 385), and Sections 201 and 308 of the Small Business Investment Act (72 Stat. 689, 694); to the extent that said Parts 112 and 113 are applicable to such assistance.
   - f. To the best of my knowledge and belief, I am not able to obtain a bond for the above described project on reasonable terms and conditions without guarantee assistance by SBA.

2. The date, time and place of the bid opening is as follows:

Date MARCH, 21, 1974

Time 2.00 PM

Place CITY MANAGERS OFFICE
CITY HALL BLDG.
NEWBURGH NEW YORK

3. I have read the "Contractor's Fee" section (reverse side) and agree to abide by this fee schedule, PROVIDED I receive the contract sought and SBA extends its bond guarantee. I also agree to pay the contractor's guarantee fee to my Agent/Broker at the time I receive the bond, in accordance with Paragraph 9, reverse side.

4. I presently ☐ do not have an SBA Loan
☐ do have an SBA Loan through the ______ office
with a balance of $ ______ as of (date) ______

5. I ☐ am ☐ am not an SBA 8(a) Qualified Contractor
This bond application ☐ does ☐ does not pertain to an 8(a) contract

6. Applicant hereby authorizes any agent, broker or surety company in possession of credit, financial or work experience information concerning the undersigned applicant and the applicant's business to release the same to SBA, in order that SBA may evaluate the same for the purpose of bond guarantee assistance.

7. I hereby certify that all information presented herein is complete and accurate to the best of my knowledge.

SIGNATURE (Applicant) STATE MECHANICAL COMPANY, INC. Jack Martin Pres.

Executed this date 4/29/74

SBA Form 994 (5-73) REF: SOP 50 45 PREVIOUS EDITIONS ARE OBSOLETE

SMALL BUSINESS ADMINISTRATION

## SURETY BOND GUARANTEE UNDERWRITING REVIEW

SURETY COMPANY: INTERNATIONAL FIDELITY INS. CO.

PRINCIPAL NAME: JACK MARTIN

SBG NO.: 20181-023

APPLICANT'S TRADE NAME AND ADDRESS:
STATE MECHANICAL CO. INC.
444 MAIN STREET
MT. KISCO, N.Y.

Items 1-16 are to be completed on each bond Guarantee Submission to SBA, including the Initial Submission and All Subsequent Submissions.

### A. SURETY'S REVIEW

1. JOB DESCRIPTION AND LOCATION (Including Obligee): HEATING, VENTILATING AND AIR CONDITIONING AT NEW PUBLIC SAFETY BLDG., NEWBURGH, N.Y. OBLIGEE IS CITY OF NEWBURGH, N.Y.

2. CONTRACT AMOUNT Approx on Bid; Exact on Performance: 343,553

3(a). BOND $ OR %: 100%

3(b). PENALTY CLAUSE ☐ YES ☐ NO

4. BOND NUMBER: UNASSIGNED

5. IS PRESENT PROJECT SIMILAR TO PREVIOUS WORK PERFORMED? ☒ YES ☐ NO

6. WHEN DOES JOB BEGIN? A.S.A.P.

7. SCHEDULED COMPLETION DATE: SEPT, 1975

8. HOW MUCH AND STATUS OF WORK IN PROGRESS? ANOTHER 219,000 LEFT ON JOB AT GOSHEN, N.Y. SBG # 20181-02

8(a). VERIFIED BY OBLIGEE(S) ☒ YES ☐ NO

8(b). HOW MANY? ONE

8(c). OF HOW MANY? ONE

9(a). HAS SURETY CHECKED WITH SUPPLIERS? ☐ YES ☒ NO

9(b). HOW MANY?

9(c). OF HOW MANY?

10(a). DATE OF FINANCIAL STATEMENT: 12/31/73 FY End

10(b). IS THERE SUFFICIENT WORKING CAPITAL? ☒ YES ☐ NO

10(c). FINAL (PAYMENT/PERFORMANCE) BOND BID? ☒ YES ☐ NO

10(d). WHAT IS BID SPREAD? 15,000 NEXT BIDDER

NOTE: If this review is for a bid bond request, the Surety must forward SBA a listing of the Bid Spread prior to Surety's issuance of the final bonds.

11(a). SUBCONTRACTORS INVOLVED IN THIS JOB? ☐ YES ☒ NO

11(b). PARTICIPATION %

11(c). BONDED? ☐ YES ☐ NO

12. IS CONTRACT SBA 8(a)? ☐ YES ☒ NO

13(a). DOES CONTRACTOR REQUIRE FINANCIAL/MANAGEMENT/TECH ASSISTANCE? ☐ YES ☒ NO

13(b). IF YES WHAT TYPE?

14. REMARKS/CONCLUSIONS

15. CONTINUATION SHEET ATTACHED — CHECK (✓) ☐

16. SBA FORM 990 (Guarantee Agreement) ATTACHED — CHECK (✓) Y

Items 17-35 are to be completed only on the initial submission and its Annual Up-Date

17. TYPE AND AMOUNT OF CONTRACTUAL WORK THIS CONTRACTOR HAS DONE PREVIOUSLY.

18(a). LARGEST PREVIOUS CONTRACT $

18(b). LARGEST PREVIOUS WORK PROGRAM $

19(a). ANY DISPUTES? ☐ YES ☐ NO

19(b). ON SCHEDULE? ☐ YES ☐ NO

20(a). HAS CONTRACTOR EVER FAILED TO COMPLETE JOB? ☐ YES ☐ NO

20(b). DETAILS

21. WHAT IS EXPERIENCE(S) OF OFFICERS AND/OR OWNERS?

22(a). CONTRACTOR HAVE ADEQUATE EQUIP? ☐ YES ☐ NO

22(b). OWNED? ☐ YES ☐ NO

22(c). LEASED? ☐ YES ☐ NO

23. CONTRACTOR'S TAXES CURRENT? ☐ YES ☐ NO

24. CONTRACTOR INSURANCE COVERAGE SUFFICIENT? ☐ YES ☐ NO

25(a). SURETY RECEIVED COPY OF CURRENT FINANCIAL STATEMENT? ☐ YES ☐ NO

25(b). DATE OF FINANCIAL STATEMENT

25(c). PREPARED BY WHOM?

26(a). FINANCIAL STATEMENT SHOW DISCLAIMER? ☐ YES ☐ NO

26(b). TYPE OF FINANCIAL STATEMENT ☐ CASH ☐ SIMPLE ACCRUAL ☐ COMPLETED CONTRACT ☐ % COMPLETION

27(a). NET WORTH $

27(b). NQA

28(a). SURETY VERIFIED BANK BALANCE? ☐ YES ☐ NO

28(b). AVG BANK BALANCE $

SBA Form 994B (2-73) PREVIOUS EDITIONS ARE OBSOLETE.

| | | |
|---|---|---|
| CONTRACTOR HAVE BANK LINE OF CREDIT?<br>☐ YES ☐ NO | WITH WHOM? | HOW MUCH LINE OF CREDIT? |

| | | | |
|---|---|---|---|
| VERIFICATION OF PAYABLES?<br>☐ YES ☐ NO | AGED? (% over 60 days) | HOW MANY? | OF HOW MANY? |
| VERIFICATION OF RECEIVABLES?<br>☐ YES ☐ NO | AGED? (% over 60 days) | HOW MANY? | OF HOW MANY? |

ANY REMARKS FROM CREDITORS CONCERNING THIS CONTRACTOR

| | | | |
|---|---|---|---|
| CONTRACTOR HAVE CURRENT SBA LOAN?<br>☐ YES ☐ NO | HOW MUCH & STATUS? | PREVIOUS SBA LOAN?<br>☐ YES ☐ NO | SBA LOAN APPLIC. PENDING?<br>☐ YES ☐ NO |

| | | |
|---|---|---|
| CONTRACTOR PREVIOUSLY BONDED?<br>☐ YES ☐ NO | AMOUNT<br>$ | WITH WHOM? |

| | | | |
|---|---|---|---|
| CONTRACTOR HAVE BONDING LINE?<br>☐ YES ☐ NO | AMOUNT<br>$ | PREVIOUS SBA BOND GUAR.?<br>☐ YES ☐ NO | AMOUNT & STATUS |

In our opinion, the principal appears to have the financial/management/technical abilities necessary to successfully complete this contract; however, we feel this contractor falls below the normal underwriting standards of our company, and we cannot issue bonds to this contractor without the SBA Guarantee.

UNDERWRITER William J. O'Grady
WILLIAM J. O'GRADY

DATE 6/14/74

ADDRESS (Include Zip Code)

TELEPHONE (Include A/C)

B. SMALL BUSINESS ADMINISTRATION'S REVIEW

| | | | |
|---|---|---|---|
| 1. SBS NO. (With Suffix)<br>20181-03 | REVIEW OF INITIAL BOND?<br>☑ YES ☐ NO | SUBSEQUENT BOND?<br>☑ YES ☐ NO | MEETS SIZE STANDARDS?<br>☑ YES ☐ NO |
| CONTRACTOR NEEDS FIN/MG/TECH ASSIST.?<br>☐ YES ☑ NO | WHAT TYPE? | REQUEST OTHER SBA ASSIST. 8(a) ETC.?<br>☐ YES ☑ NO | WHAT TYPE? |

IF NECESSARY ASSISTANCE IS NOT READILY AVAILABLE IN GOVERNMENT, HAVE YOU REFERRED APPLICANT TO FUNDED ASSISTANCE PROGRAMS I.E., MINORITY CONTRACTORS ASSISTANCE PROGRAM (MCAP) ETC.?
(NAME ASSISTANCE): N/A

BASED ON THE ABOVE:
THERE: ☑ IS ☐ IS NOT REASON TO EXPECT SUCCESSFUL COMPLETION OF THE CONTRACT.

THE COSTS ☑ DO ☐ DO NOT APPEAR TO BE REASONABLE

IT HAS BEEN DETERMINED THAT THE REQUESTED BOND(S):
☑ IS ☐ ARE NECESSARY AND THE SURETY COMPANY HAS INDICATED THAT IT WILL NOT ISSUE THE BOND(S) WITHOUT THE SBA GUARANTEE.

REMARKS/CONCLUSIONS

ATTACHMENTS (Check Appropriate Box)

| | | | |
|---|---|---|---|
| CONTINUATION SHEET ☐ | SBA FORM 990 ☑ | CONTRACTORS CURRENT FINANCIAL STATEMENT ☑ | COPIES OF BONDS ☐ |

WE ARE IN RECEIPT OF SBA FORM 912 ☑ AND APPROPRIATE SBA FORM 994 FOR THIS CONTRACTOR AND JOB. ☑

RECOMMENDATION ☑ APPROVAL ☐ DISAPPROVAL

| | | |
|---|---|---|
| REVIEWING OFFICIAL (Signature)<br>Edward J. Ryan | TITLE<br>E/DS | DATE<br>7/3/74 |
| APPROVING OFFICIAL (Signature) | TITLE<br>Chief CED Branch<br>F & I Div. SBA<br>D O NYC | DATE<br>7/3/74 |

SBA Form [illegible] (3-73)

(005582)

**UNDERWRITERS WORKSHEET**

1. AMOUNT OF BOND $ 343,553 2. BOND TYPE CODE 3 9 0

3. BOND DESCRIPTION (brief) PERF. PAY - HEATING, VENTILATING & AIR CONDITIONING AT NEW PUBLIC SAFETY BUILDING

4. S.B.A. CODE 1 1 1 5. AGENCY CODE 5 4 4 4 3 6. STATE CODE 4 1 7. N.Y.C.

8. EFFECTIVE DATE 07 /08 /74 9. EXPIRATION DATE 07 /08 /76 10. TERM 2 YEARS

11. PRINCIPAL'S NAME STATE MECHANIC

AND ADDRESS 444 MAIN STREET, MT. KISCO, N.Y.

12. OBLIGEE CITY OF NEW ROCHELLE N.Y.

13.

| PREMIUM | COMM. RATE | COMMISSION | NET PREMIUM | DIRECT | OVERRIDE |
|---|---|---|---|---|---|
| 2584 | 10%. | 258.40 | 2,325.60 | | E. 387.60 |

14. BROKER NAME AND ADDRESS V. DAVID LEVITT
22 WEST 1ST STREET, MT. VERNON, N.Y. 10550

S. B. A. X 258.40

## SPECIAL INSTRUCTIONS

A. SEND BOND TO: ☐ PRINCIPAL ☒ BROKER B. SEND BILL TO: ☐ PRINCIPAL ☒ BROKER

C. GIVE BOND TO:

D. BOND WILL BE PICKED-UP AT ______ (TIME) BY

E. (NAME) IS WAITING.

F. COLLATERAL DESCRIPTION:

GIVE TO:

G. TYPE "SPEED MEMO" MESSAGE TO:

SBA

H. TYPE LETTER ON COMPANY LETTERHEAD TO:

AT (ADDRESS)

MESSAGE:

I. S.B.G. No.: 20191-09

J. OTHER INSTRUCTIONS:

STATE MECHANICAL CO INC - PRINCIPAL

PREPARED BY W (INITIALS) DATE 07/08/74

FORM AS—150 (10-73)

INTERNATIONAL FIDELITY INSURANCE COMPANY

CC. 1

SMALL BUSINESS ADMINISTRATION

## GUARANTEE AGREEMENT UNDER TITLE IV, PART B, OF THE SMALL BUSINESS INVESTMENT ACT OF 1958, AS AMENDED

This agreement, made and entered into this 14th day of JUNE, 1974,

by and between the Small Business Administration, an agency of the United States Government, hereinafter referred as SBA and

INTERNATIONAL FIDELITY INSURANCE CO., hereinafter referred to as Surety,

relative to STATE MECHANICAL CO. INC, hereinafter referred to as Principal,

who has applied for bonds required for CONSTRUCTION OF PUBLIC SAFETY BLDG. AT NEWARK, N.J. WORK CONSISTS OF HEATING, VENTILATION AND AIR CONDITIONING
(describe project)

WITNESSETH: That in consideration of the mutual convenants and agreements herein contained, the parties agree as follows:

1. Surety agrees, conditional on the execution of this guarantee by SBA, to become surety on the bid bond and if Principal's bid price is in line with other bidders in Surety's opinion and the contract price does not exceed $500,000, to become surety on performance, payment, maintenance, or any other bonds necessary or incidental to the performance of the above described contract executed on behalf of the Principal. The agreement in this paragraph shall not apply unless all prescribed underwriting conditions are met, nor shall it apply if subsequent or additional information comes to the attention of the Surety of a nature to change its underwriting decision as to the desirability of executing any of the aforementioned bonds.

2. Surety represents that such bond or bonds when executed by it as to terms and conditions will be in accord with those executed by professional sureties for the type of contract for which such bond or bonds are required to be furnished by Principal.

3. Surety affirms that without this SBA guarantee to Surety it will not issue any of said bonds to Principal.

4. SBA hereby agrees to guarantee to Surety 90% of any "loss" Surety may sustain or incur in good faith by reason of its execution of the bid, payment or performance bond contemplated by this Agreement.

5. SBA agrees that the term "loss" as used in this Agreement shall mean any and all liability, damages, court costs, counsel fees, charges and expenses of whatever kind or nature which the Surety shall or may, at any time, sustain or incur by reason, or in consequence, of having executed the bond or bonds herein guaranteed by SBA.

6. The Surety shall be entitled to credit for any and all disbursements, in and about the matters herein contemplated, made by it in good faith under the belief that it is or was liable for the sums and amounts so disbursed, or that it was necessary or expedient to make such disbursement (including efforts to diminish "loss"), whether such liability, necessity or expediency existed or not, and vouchers or other evidence of such disbursement shall be taken as prima facie evidence against SBA of the fact and extent of SBA's liability to Surety.

7. SBA agrees that Surety shall be entitled to reimbursement on a calendar quarterly basis under this guarantee for its loss, adjusted pro rata for any payments received by Surety from any other source.

8. Surety agrees that if any suit or claim is brought or instituted against Surety upon said bond or bonds, inform SBA of the same within a reasonable time of receipt of the summons and complaint or claim in the office. Unless otherwise agreed, Surety shall take charge of all claim matters arising under said bonds; liability and the amount thereof; compromise, settle or defend any claim or suit; and, take such action as necessary to minimize loss.

9. Subsequent to the signing of the contract by the parties obligated thereon and the execution of the bonds guaranteed herein, no act or omission of the Surety in modifying, amending, limiting or extending any instrument executed by the Surety, nor the execution of any consent to the contract or bond(s) herein referred to, shall in anywise affect the liability of SBA hereunder, nor shall SBA be released from this obligation by reason thereof; and it is further agreed that Surety may thereafter alter, change, modify, amend, limit or extend any instrument or may execute renewal thereof, or other and new obligations in its place or in lieu thereof without notice to SBA, and in such case SBA shall be liable to Surety as fully and to the same extent on account of any such altered, changed, modified, amended, limited or extended instrument or such renewals thereof, or other or new obligations in its place or in lieu thereof, as fully as if such instrument were described at length herein.

10. Surety agrees to pay SBA 10% of its bond(s) premium for and in consideration of SBA's agreement to guarantee the bid, payment or performance bond contemplated by this Agreement. It is further agreed by SBA and Surety that Surety will pay SBA an additional like percentage of the additional premiums collected on any increase in contract price and SBA will make a like percentage refund on any premium reductions resulting from a reduction in the contract price. Where SBA or Surety's share of any additional premium increase or decrease is Five Dollars ($5.00) or less, there shall be no adjustment.

IN WITNESS WHEREOF, the parties have caused this Agreement to be executed the date and year first above written.

International Fidelity Insurance Co
SURETY

By
William J. O'Grady, Attorney in Fact

SMALL BUSINESS ADMINISTRATION

By

Amount of Contract $343,553
Date 11/22/74

Bond Amount: Bid ______ Performance 343,553 Payment 343,553
Date June 20th, 1974
Premium Charged (and % Rate) 2553 Premium 10 & 6.50 Rate apply
Scheduled Contract Completion Date Sept., 1975

SBA FORM 990 (3-72)

CITY OF NEWBURGH
OFFICE OF CORPORATION COUNSEL
NEWBURGH, N. Y.

STAFF COUNSEL
Bernard J. Sommer
Tel. 561-9400
Scott G. Kissner
Tel. 562-1122
John J. Hayden
Tel. 294-8622

DEPARTMENT OF LAW
CORPORATION COUNSEL
J. Otto Williams
Tel. 561-1913
ASSISTANT CORPORATION COUNSEL
Joseph P. Rones
Tel. 561-5656
565-4250

file

January 12, 1976

State Mechanical Corp.
444 Main Street
Mt. Kisco, New York

Re: City of Newburgh
Public Safety Bldg.

Gentlemen:

Your firm has failed to supply enough workmen or materials to perform your obligations pursuant to the contract documents, failed to make prompt payment to subcontractors and are guilty of other substantial breaches of the contract documents.

Therefore, without prejudice to any other right or remedy of the City, your employment is hereby terminated. The City claims possession of the site and of all materials, equipment, tools, construction equipment and machinery of yours which is located on the site.

The foregoing action is taken pursuant to Section 14.2 of the General Conditions of the contract documents.

Very truly yours,

/S/

JOSEPH P. RONES
Ass't. Corporation Counsel

JPR/mmc
cc: C. Remick, G. Zimmerman, J. Taylor
D. Samson, International Fidelity Ins. Co.

CERTIFIED MAIL, RETURN RECEIPT REQUESTED NO. 431571

WITFIELD
& REMICK
architects

35 wisner avenue
newburgh, new york
(914)561-0100 12550

December 30, 1975

State Mechanical Co., Inc.
100 Diplomat Drive
Diplomat Towers, Suite 3-H
Mt. Kisco, NY 10549

Re: Public Safety Building

Gentlemen:

During a meeting held today between James Taylor, City Manager, Joe Rones, the City's Corporation Council, and this office, we were advised to contact you regarding the lack of progress of the heating, ventilating and air conditioning work on this project.

In accordance with the General Conditions of the Contract for Construction, Paragraph 14.2.1, we are notifying you herewith that you have repeatedly failed to supply enough properly skilled workmen and materials on this job, have failed to make prompt payment to Subcontractors for materials and labor, have failed to maintain a schedule of progress consistent with the special conditions, Paragraph 1D. 1H (heat during construction), and have substantially violated other provisions of the Contract Documents.

We have notified the General Contractor that his responsibility for the provision of temporary heat ended on December 29, 1975, and that this responsibility becomes yours as of that date.

This letter is to be considered the seven days written notice referred to in Paragraph 14.2.1 of the Specifications, and unless you indicate to the Owner and this office within the next seven days the initiatives you intend to take to completely eliminate each of the above Contract violations, the Owner will be forced to terminate your Contract.

donald a. witfield
conrad r. remick, a.i.a.

It is extremely important that the Owner occupy this facility as soon as possible.

Very truly yours,

Conrad R. Remick

CONRAD R. REMICK, A.I.A.
WITFIELD & REMICK
ARCHITECTS

CRR: sls

cc: James Taylor
Joe Rones
Gerald Zimmerman
Abrams Moses Solomon
International Fidelity Insurance Co.

Phone 988-1675

PROGRESS BUILDERS - 3.2

RESIDENTIAL and COMMERCIAL

P. O. BOX 221, ASBURY PARK, N. J. 07712

7

CONSIDERED BY PROGRESS BUILDERS TO BE THE CONTRACT

May 19, 1976

David Samson, Esq.
80 Main Street
West Orange, N.J. 07052

Re: State Mechanical Completion Contract
Public Safety Building
Newburgh, N.Y.

Dear Dave:

After our phone conversations, we understand that the above titled job will be handled in the following manner. The three sub-contractors of State Mechanical will receive the balance of monies under their original contracts from Progress Builders.

Cost increases will be added to the original contract balances because of the failure of State Mechanical to supply items called for under State Mechanical's contract or because State Mechanical removed items from the job-site that had already been supplied by the subs.

The accounting of the sub-contractors contract amounts is as follows:

1- Elmsford Sheetmetal Works, Inc.
11 South Broad Street
Peekskill, N.Y. 10566

| | | | |
|---|---|---|---|
| Original Contract | $100,000.00 | | |
| Registers and Grilles | 6,089.00 | | |
| Escalation Costs | 3,395.00 | | |
| Total Contract to date | | $109,484.00 | |
| Amount paid under State | 68,418.00 | | |
| Amount paid by Internat'l | 4,800.00 | | |
| Fidelity | 16,182.00 | | |
| Total paid to date | | 89,400.00 | |
| Amount assumed by Progress | | | $20,084.00 |

2- Powers Regulator Company
30 Commerce Street
Springfiled, N.J. 07081

| | | | |
|---|---|---|---|
| Original Contract | 32,750.00 | | |
| Pneumatic Valves | 2,323.00 | | |
| Escalation Costs | 2,540.00 | | |
| Total Contract to date | | 37,613.00 | |
| Amount paid under State | 0. | | |
| Amount paid by Internat'l Fidelity | 13,275.00 | | |
| Total paid to date | | 13,275.00 | |
| Amount assumed by Progress | | | 24,338.00 |

Phone 988-1675

PROGRESS BUILDERS

RESIDENTIAL and COMMERCIAL

P. O. BOX 221, ASBURY PARK, N. J. 07712

May 19, 1976

Continued from Page 1

3- Jersey Insulation Corporation
20 Dover Street
Paterson, N.J. 07501

| | | | |
|---|---|---|---|
| Original Contract | $19,450.00 | | |
| Added costs to date | 0. | | |
| Total Contract to date | | 19,450.00 | |
| Amount paid under State | 0. | | |
| Amount paid by Internat'l Fidelity | 12,240.00 ✓ | | |
| Total paid to date | | 12,240.00 | |
| Amount assumed by Progress | | | $ 7,210.00 |
| Total Amount Assumed by Progress for sub-contractors of State Mechanical | | | $51,632.00 |

Progress Builders will add the $51,632.00 to its base contract of $147,208.00 to bring the total contract price to date of $198,840.00

We await any response or modification to this letter at your earliest convenience.

Very truly yours,

Donald G. Irvin

Donald G. Irvin

Dun & Bradstreet, Inc.

BE SURE NAME, BUSINESS AND
ADDRESS MATCH YOUR FILE.

LATER REPORT
WILL FOLLOW

This report has been prepared for:

SUBSCRIBER: 004-005364

18374004 [illegible] 00006376

SPECIAL RESPONSE

DUNS: 06-105-7642
PROGRESS BUILDERS

DATE PRINTED
NOV 18 1980

5

PO BOX 221
ASBURY PARK NJ 07712

Correct address is Neptune, NJ. Business is reported as Irvin Builders.

Reporter: Lynn Anderson

11-18(000 /7 )0537/04 090322830 090

THIS REPORT, FURNISHED PURSUANT TO CONTRACT FOR THE EXCLUSIVE USE OF THE SUBSCRIBER AS ONE FACTOR TO CONSIDER IN CONNECTION WITH CREDIT, INSURANCE, MARKETING OR OTHER BUSINESS DECISIONS, CONTAINS INFORMATION COMPILED FROM SOURCES WHICH DUN & BRADSTREET, INC. DOES NOT CONTROL AND WHOSE INFORMATION, UNLESS OTHERWISE INDICATED IN THE REPORT, HAS NOT BEEN VERIFIED. IN FURNISHING THIS REPORT, DUN & BRADSTREET, INC. IN NO WAY ASSUMES ANY PART OF THE USER'S BUSINESS RISK, DOES NOT GUARANTEE THE ACCURACY, COMPLETENESS, OR TIMELINESS OF THE INFORMATION PROVIDED, AND SHALL NOT BE LIABLE FOR ANY LOSS OR INJURY WHATEVER RESULTING FROM CONTINGENCIES BEYOND ITS CONTROL OR FROM NEGLIGENCE. 9R2-10 (780128)

©Dun & Bradstreet, Inc.

BE SURE NAME, BUSINESS AND
ADDRESS MATCH YOUR FILE.

ANSWERING
INQUIRY

This report has been prepared for:

SUBSCRIBER: 004-005364
Pete

837 [illegible]

FULL REVISION

DUNS: 06-105-7642
IRVIN BUILDERS INC

1107 SEVENTH AVE
NEPTUNE NJ 07753
TEL: 201 988-1675

DATE PRINTED
NOV 18 1980

OPERATIVE BUILDER
SIC NO.
15 31

| SUMMARY | |
|---|---|
| RATING | -- |
| STARTED | 1965 |
| PAYMENTS | SEE BELOW |
| SALES | $2,000,000 |
| EMPLOYS | 2-4 |
| HISTORY | CLEAR |

CHIEF EXECUTIVE: L GARY IRVIN, PRES

PAYMENTS (Amounts may be rounded to nearest figure in prescribed ranges)

| REPORTED | PAYING RECORD | HIGH CREDIT | NOW OWES | PAST DUE | SELLING TERMS | LAST SALE WITHIN |
|---|---|---|---|---|---|---|
| 7/80 | Disc | 10000 | | | 2 10 N30 | |
| | Ppt | 20000 | | | N30 | |
| 3/80 | Disc | 5000 | 2500 | | 5 10 N30 | |

**FINANCE**
**08/18/80**

On AUG 08 1980 L Gary Irvin, president, declined financial statement. Reporters estimates:
Sales for 1 year were $2,000,000.

**BANKING**
**07/80**

Balances average medium five figures. Account open over three years. Now owing moderate five figures. Loan(s) unsecured. Payments as agreed. Relations satisfactory.

**HISTORY**
**08/18/80**

L GARY IRVIN, PRES
DIRECTOR(S): THE OFFICER(S)

Incorporated NJ Nov 5 1971. Authorized capital consists of 1,000 shares common stock, no par value.

Business started individually 1965 by L Gary Irvin.

100% of capital stock is owned by L Gary Irvin.

IRVIN born 1939 married. 1960-1965 mason working out of Union Local 22, Union, NJ.

AFFILIATE: Irvin is also Pres of Progress Management Inc, located here. Incorporated May 13 1971 it operates as an operative builder. On Aug 8 1980 Irvin, Pres, stated inter-company relations are confined to sharing facilities.

**OPERATION**
**08/18/80**

Operative builder building single family homes.

Contracts all work to others.

Payment due at closing. Sells to individuals. Territory Monmouth County. Nonseasonal.

EMPLOYEES: 2-4 including officers.

FACILITIES: Rents from Irvin 1,800 sq. ft. in 1 story cinder block building in good condition. Premises neat.

LOCATION: Suburban business section on side street.

11-18(261 /6 )0000/00 32504 090

THIS REPORT, FURNISHED PURSUANT TO CONTRACT FOR THE EXCLUSIVE USE OF THE SUBSCRIBER AS ONE FACTOR TO CONSIDER IN CONNECTION WITH CREDIT, INSURANCE, MARKETING OR OTHER BUSINESS DECISIONS, CONTAINS INFORMATION COMPILED FROM SOURCES WHICH DUN & BRADSTREET, INC. DOES NOT CONTROL AND WHOSE INFORMATION, UNLESS OTHERWISE INDICATED IN THE REPORT, HAS NOT BEEN VERIFIED. IN FURNISHING THIS REPORT, DUN & BRADSTREET, INC. IN NO WAY ASSUMES ANY PART OF THE USER'S BUSINESS RISK, DOES NOT GUARANTEE THE ACCURACY, COMPLETENESS, OR TIMELINESS OF THE INFORMATION PROVIDED, AND SHALL NOT BE LIABLE FOR ANY LOSS OR INJURY WHATEVER RESULTING FROM CONTINGENCIES BEYOND ITS CONTROL OR FROM NEGLIGENCE. 9R2-10 (780128)

July 9, 1976

Mr. Fred Mitterhoff
President
International Fidelity Insurance Company
24 Commerce Street
Newark, New Jersery 07102

RE: State Mechanical Co., Inc.
SBG-20181-02 (Bond No. 001828)
SBG-20181-03 (Bond No. 005582)

Dear Fred:

I am in receipt of your reimbursement request dated July 7, 1976. This bordereaux will be processed next week, together with yours of June 3, 1976, at least as much of it as we can.

As I have told you numerous times before, we cannot and will not reimburse any surety for losses incurred on any alleged default/claim file until and unless I have received from the Surety a default notice and appropriate, comprehensive and current status reports thereon. Under no circumstances is a default/claim file not to be updated to me at least semi-annually (from date of last report.)

Frankly, your company has been one of our worst offenders on the above score.

We will not pay one cent to a Surety as loss reimbursement without prior notice of default, appropriate claim documentation, and a posting of an appropriate incurred loss [paid plus outstanding reserves (contract proceeds remaining plus retainages; less, legal and adjusting fees, plus outstanding claims, plus est. completion costs, plus back-charges asserted, plus liquidated damages assessed)].

The referenced file is a case in point, though there are others which I will correspond to you about in the near future, including BNS.

To this date, I have not received any default notices from you on State Mechanical Company, Inc.; nor have I received any consequential status reports, though you have included billings in your bordereaux as follows: 02-26-76, 04-01-76, 05-12-76, 06-03-76, and 07-07-76. These billings total $263,153.20 (SBG-20181-02 = $110,755.21, and SBG-20181-03 = $152,397.99).

Our reimbursements on these billings will be withheld until the matters discussed above are cleared up to my full satisfaction.

Sincerely,

Danny J. Gibb
Chief Underwriter
Surety Bond Guarantee

SBG/Gibb/em 7/9/76

cc: Chambers
Surety
Ryan - NY D.O - SBG
Contractor
Region II file

LIEB, WOLFF & SAMSON
A PROFESSIONAL CORPORATION
ATTORNEYS AT LAW
80 MAIN STREET
WEST ORANGE, NEW JERSEY 07052

201-325-2700

DAVID SAMSON
JOEL A. WOLFF
L. ROBERT LIEB
ELLEN B. KULKA
MICHAEL B. GOODMAN *
JOHN E. FINNERTY

* MEMBER OF NEW YORK BAR ONLY

NEWARK OFFICE
10 COMMERCE COURT
NEWARK, NEW JERSEY 07102

March 8, 1976

Mr. Fred Mitterhoff
International Fidelity Ins. Co.
24 Commerce Street
Newark, New Jersey 07102

Re: State Mechanical Co., Inc.
Obligee: City of Newburgh - Public Safety Building
Bond #005582, dated July 8, 1974
Amount: $343,553.00
Reinsurance: SBG #20181-03

Dear Mr. Mitterhoff:

I am enclosing herewith recommendations from your contractor, Progress Builders, Inc., with respect to amounts due to subcontractors and materialmen on this project. It would appear that these recommendations for payment have been made by your contractor on the basis of what is necessary in order to complete the project. We have not reviewed the specifics of the claims involved nor have we made any independent determination as to their respective merit.

On the basis of your contractor's recommendations, we would request that you issue your checks as follows:

| | | | | |
|---|---|---|---|---|
| a) | Elmsford Sheetmetal Works | - | $ 16,182.00 | Pn-B- 699 |
| b) | " " " | - | $ 4,800.00 | " " - 700 |
| c) | Jersey Insulation Corp. | - | $ 12,240.00 | Reg. 5763 |

You will note that Progress Builders has also made a request for payment to Powers Regulator Company in the amount of $13,275, which we previously requested by our letter of

3/11/76

February 26, 1975. Kindly forward this check as well, together with your letter agreement.

Very truly yours,

LIEB, WOLFF & SAMSON

DAVID SAMSON

DS:jet

Enc.

SBA

**U.S. Small Business Administration**
Office of Inspector General
Office of Internal Audit

# Report of Internal Audit on

STATE MECHANICAL CO., INC.
SBG NO. 0200-20181-003-30
BONDED THROUGH
INTERNATIONAL FIDELITY INSURANCE CO.

Audit Report No: 14-81
Copy No: 4
September 18, 1981

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## I. CONCLUSIONS AND RECOMMENDATIONS

### A. Conclusions

Our review of the subject claim, resulting in a loss to the Agency of $205,474 to date, disclosed the following deficient conditions related to the surety's handling of the claim:

1. Arbitrary Selection of Replacement Contractor - The surety's claims adjuster negotiated an agreement with the replacement contractor which resulted in payments by the surety totalling about $198,000. Of this amount, the replacement contractor and an affiliated business made a profit of about $70,000. Our review indicated that the claims adjuster may have selected the replacement contractor in an arbitrary manner.

   The claims adjuster did not obtain bids from other potential replacement contractors. Competitive bids could have been significantly lower or at least could have supplied the claims adjuster with a basis for negotiating a contract. The contract was for mechanical work (plumbing, heating, and air conditioning) which normally would have been performed by a mechanical contractor. However, the replacement contractor was a general contractor. The work site was geographically remote from the replacement contractor's place of business. Therefore, the replacement contractor would have had to work in an unfamiliar area and include substantial travel costs in his price. As a result, the replacement contractor subcontracted nearly all of the work to a mechanical contractor located near the work site and his $70,000 profit appeared to be earned for merely administering the contract.

2. SBA Erroneously Charged for a Loss on a Non-Guaranteed Bond - The surety erroneously charged a $9,400 payment as a loss against the subject bond. The $9,400 payment was in fact a loss incurred against a non SBA guaranteed bond. SBA reimbursed the surety for 90 percent of this amount or $8,460.

### B. Recommendations

1. Concerning the first deficiency, no specific corrective action is recommended. Implementation of the recommendations in Finding No. 1 of our internal audit, recommending that SBA adopt procedures for motivating sureties to minimize losses, should correct the causes of this deficiency.

2. Concerning the second deficiency, we recommend that SBA obtain reimbursement from the surety in the amount of $8,460 for the erroneously charged payment. (We discussed this deficiency and our recommendation with program officials in the Office of Special Guarantees. They agreed to initiate immediate action to obtain a refund from the surety.)

## II. BACKGROUND

This claim audit is one of 14 conducted as an extension of our internal audit of the Surety Bond Guarantee Program, reported in Office of Internal Audit Report No. 4-81 dated April 14, 1981, to which this report is a supplement. The purpose of these claim audits was to examine in more detail surety claims handling activities resulting from defaulted surety bonds guaranteed by SBA.

The 14 claims chosen for review were selected based on the size and nature of losses, the dates of default, and the sureties involved.

## III. AUDIT SCOPE

In order to determine the reasonableness and legitimacy of the losses and the propriety of the surety's and its representatives' actions associated with the subject claim, we reviewed accounting and other records maintained by the surety, the surety's claims adjuster, and the replacement contractor. We also interviewed representatives of the surety, one of the owners of the principal firm, the owners of the replacement firm and the attorney handling litigation against the indemnitors.

## IV. CLAIM HISTORY

Based on the principal's lack of progress and complaints of overdue payments received by the obligee from the principal's suppliers and subcontractors, the obligee, on December 30, 1975, notified the principal that it had seven days to correct the situation or face termination for default. On January 12, 1976, the principal was declared in default and was terminated. The obligee notified the surety requesting it to take over the contract and ensure its completion in a timely manner to avoid costly delays. The surety contacted the replacement contractor to analyze the situation and perform the work necessary to keep the job going. On May 19, 1976, the replacement contractor submitted a proposal to the surety for completing the work. The proposal was accepted and became the contract between the surety and the replacement contractor. No formal written contract was executed. The replacement contractor completed the job in April 1978. In June 1979, the surety paid a delay claim to the obligee and, except for subrogation, considered the case closed.

## V. CURRENT STATUS

In March 1980, the surety filed suit against the indemnitors. Only one of the three indemnitors has been located. He has agreed to settle for $50,000. Actions against the indemnitors are the only remaining activities concerning this claim. Except for costs to be incurred in pursuing indemnitors, no additional losses are anticipated. SBA considers this claim to be active.

APPENDIX A

## Contract and Default Statistics

| | | | |
|---|---|---|---|
| Original Contract | | | $343,553 |
| Change Orders | | | 3,433 |
| Revised Contract | | | 346,986 |
| Loss on Default: | | | |
| SBA's Share (90%) | | $205,474 | |
| Surety's Share | | 22,830 | |
| Total | | | 228,304* |
| Total Cost to Complete Contract | | | $575,290 |

## Composition of Default Loss

| | | | |
|---|---|---|---|
| Direct Costs: | | | |
| Replacement Contractor | | | $198,840 |
| Subcontractors and Suppliers | | | 79,797 |
| Delay Claim | | | 36,000 |
| Total | | | 314,637 |
| Loss Adjustment Expenses: | | | |
| Claims Attorney | | | 10,249 |
| Total Payments | | | 324,886 |
| Recoveries: | | | |
| Contract Amount | | $346,986 | |
| Payments to Principal | $247,404 | | |
| Liquidated Damages | 3,000 | | |
| Total Reductions | | (250,404) | |
| Payments to Surety | | | (96,582) |
| Loss on Default | | | $228,304 |

* This amount includes a payment of $9,400 erroneously charged to this bond as explained in Part I.A.

APPENDIX B

## Claim Data

Principal : State Mechanical Co., Inc.
Mount Kisco, New York
(no longer in existence)

Surety : International Fidelity Insurance Co.
Newark, New Jersey

Adjuster : Law Firm of
Kimmelman, Lieb, Wolf, and Samson
David Samson
West Orange, New Jersey

Obligee : City of Newburgh
Newburgh, New York

Owner : Same as obligee

Contract : Dated May 16, 1974
Amount of $343,553
Heating, plumbing, ventilation

Guarantee : SBG No. 0200-20181-003-30
Dated June 14, 1974

Bond : Dated July 8, 1974
Payment and performance for $343,553

Replacement
Contractor : Progress Builders
Neptune, New Jersey

## FACT SHEET

| | | | |
|---|---|---|---|
| Principal: | Mountain Enterprises, Inc.<br>DBA Wyatts Painting & Drywall<br>Las Vegas, Nevada | | |
| Obligee: | U.S. Air Force | Bond No: | 900-00782-004-51 |
| | U.S. Navy | | 900-00782-005-53 |
| | U.S. Air Force | | 900-00782-007-57 |
| | U.S. Navy | | 900-00782-011-46 |
| Surety: | American Fidelity Fire Insurance<br>Woodbury, New York | | |
| Underwriter: | Market Insurance Corporation<br>Encino, California | | |
| Claims Adjuster: | United Inspection Bureau<br>Encino, California | | |
| Completion Contractor: | Del Sevier<br>Las Vegas, Nevada | | |
| Cost of Original Contract: | $401,513 | | |
| Loss to SBA: | $102,564 | | |

## BACKGROUND

Between May and October 1978, SBA guaranteed four bonds executed by American Fidelity Fire Insurance Company (AFF) for Mountain Enterprises, Inc. The individual contracts, totaling $401,513, were for painting buildings on two U.S. Military bases in Southern California. On May 14, 1979, the owner of Mountain, William Wyatt, abandoned all four jobs, and was subsequently declared in default. At the time of default, only one of the projects had been completed. The surety's claims adjuster, United Inspection Bureau (UIB), retained Del Sevier former supervisor for Mountain, to complete the remaining work on the three projects.

Subsequent to the default and following the completion of the projects UIB attempted to recover a portion of the surety's loss on the defaults under the General Indemnity Agreement (GIA) executed by Wyatt. However, the surety found that Wyatt had claimed ownership of real estate used to guarantee the GIA which he did not own. Wyatt has disappeared, and the surety has been unable to locate him or recover any of its and SBA's loss.

INTENTIONAL
BLANK

## FINDINGS

The SBA Inspector General and the Committee conducted separate reviews of these bonds. The investigation found that Wyatt had claimed assets he did not have on the financial statements he submitted to obtain the four bonds. Wyatt submitted financial statement to Doris Clark, an agent of Market Insurance, in connection with his application for SBA guaranteed bonds. For the period ending February 14, 1979, these statements purported that Wyatt's net worth, at fair market value, was $653,800. Approximately $465,000 of his net worth was attributable to thirteen houses Wyatt stated he owned in El Centro, California. Clark stated that Wyatt told her the actual appraised value of the thirteen houses was closer to $565,000.

In interviews with Committee staff, Clark stated that she confirmed the existence of other assets shown on Wyatt's financial statement, but did not even attempt to confirm Wyatt's ownership of the real estate in El Centro -- that is, ownership of thirteen names allegedly valued at $465,000.

Following the default, UIB was unable to contact Wyatt concerning the GIA. Therefore, UIB attempted to foreclose on the El Centro property. An investigation conducted by title companies located in Southern California showed that Wyatt had no property holdings there. Mountain Enterprises, in fact, only owned two vacant lots located in Lake Forest, California valued at $520 each, and none of the houses Wyatt stated he owned on the documents submitted to SBA.

To date, SBA, UIB and the FBI have been unable to locate Wyatt. SBA paid a total $117,865 in claims on Wyatt's bonds. There appears to be little chance for recovery.

APP[illegible] FOR SURETY BOND GUARANT[illegible] ANCE

C

TO BE COMPLETED BY PRINCIPAL

TRADE NAME OF PRINCIPAL MOUNTAIN ENTERPRISES, INC., DBA WYATT'S PAINTING AND DRYWALL

PRINCIPAL'S HOME ADDRESS: STREET, CITY AND STATE (Include ZIP)
Route 3, Box 91
Gardnerville, Nevada 89410

PRINCIPAL'S BUSINESS ADDRESS: STREET, CITY AND STATE (Include COUNTY AND ZIP)
Same as above

PRINCIPAL'S EMPLOYER ID NUMBER
88-0144634

TO BE COMPLETED BY BROKER/AGENT (Producer)

NAME OF SURETY
AMERICAN FIDELITY FIRE INSURANCE COMPANY

NAME OF BROKER/AGENT (Producer)
CLARK-LEAVITT AGENCY

BROKER/AGENT (Producer's) STREET, CITY AND STATE (Include COUNTY AND ZIP) P. O. Box 15350, Las Vegas, Clark County, Nevada 89114

BROKER/AGENT (Producer's) TELEPHONE NUMBER (Include Area Code)
702 -- 385-7195

BROKER/AGENT (Producer's) EMPLOYER ID NUMBER
none assigned yet - use 151-30-5127

1. Applicant hereby states and affirms the following: Corp. is new venture as of 10/1/77 - volume for first three months of operation was $79,228.00

a. The annual gross receipts of my business (including affiliates, as set forth in Part 121 of SBA's Rules and Regulations) during the past fiscal year was $ see above, or, as annually averaged over the past 3 fiscal years, was $ ______. (to the nearest hundreds). If there are affiliates, attach an explanation sheet, delineating annual gross receipts of each as their interests appear. If there are stockholders, attach an explanation sheet specifying what their shares of the organization(s) are.

Type of business: ☐ Proprietorship, ☐ Partnership, ☒ Corporation.
Year Business Formed: 1977 Joint Venture ☐ Yes ☒ No

b. A bid, payment or performance bond is required on the following project in order for me to serve as a ☒ primary contractor or ☐ subcontractor thereon.

c. Contractor certifies having attempted (and failed) to obtain the required bonds without the SBA's guarantee; furthermore, the contractor certifies being aware that some sureties charge higher premium rates for bonds than others do, in accordance with premium rate schedules filed in various States.

d. (1) Brief description of this contract work: Painting, Capehart Family Housing, Exterior only

(2) Estimated time required for completion: 450 days ~~(months)~~ Contract have Penalty Clause? ☒ Yes ☐ No.
If "yes", how much? $ 108.00 per calendar or wkg. day.

(3) Anticipated project start date: mo. 7 day ___ yr. 78 (4) Projected completion date: mo. 7 day ___ yr. 79

(5) Project Location: Travis AFB, California (6) Name of ☒ obligee or ☐ Prime Contractor: USA, Department of the Air Force

e. Approximate value of contract: $ 150,000.00

f. Applicant, in consideration of assistance from the SBA, herewith agrees it will comply with the nondiscrimination requirements of Title 13, Code of Federal Regulations, Part 112 and Part 113.

g. SBA is authorized to request this information under Executive Order 11625. It will be used only for statistical purposes. You are not required to disclose this information. Failure to do so will not affect your application.

(1) Principal is a ☒ Veteran ☐ Vietnam-ERA Veteran or ☐ Non Veteran (Check one)
(2) Principal is a ☒ Male ☐ Female
(3) Principal is a (0) ☐ Black, (1) ☐ Puerto Rican, (2) ☐ American Indian, (3) ☐ Hispanic (Includes Mexican-American, Cuban, Central or South American or others of Spanish Descent, (4) ☐ Asian (Includes persons of Chinese, Japanese, Korean and Filipino Descent. Also, native Hawaiians, Indonesians, Samoans, Polynesians and Micronesians, (5) ☐ Eskimos and Aleuts, (6) ☐ Undetermined, (7) ☒ Others-including Caucasians.

2. The date, time and place of the bid opening is as follows: (if applicable):
Date June 6, 1978 | Time 4:00 P.M. | Place Travis AFB, California

3. I have read the "Contractor's Processing Fee" section (reverse side) and agree to abide by this fee schedule, PROVIDED I receive the contract sought and SBA extends its bond guarantee. I also agree to pay the contractor's SBA's processing fee to my Agent/Broker in accordance with Paragraph 9 reverse side.

4. I ☒ do not have an SBA Loan. I ☐ had a previous SBA Loan. I ☐ do have an SBA Loan through the SBA Office in ______ with a balance of $ ______ as of (Date) ______ Loan No. ______

5. I ☐ am ☒ am not an SBA 8(a) Qualified Contractor (Approved business plan on file)
This bond application ☐ does ☒ does not pertain to an 8(a) contract

6. I do ☐ or do not ☒ request Management Assistance.
I have ☐ or have not ☒ previously received SBA Management Assistance.

7. I ☒ have ☐ have not received previous SBA bond guarantee, either under this trade name or another
If under another trade name, specify:
Trade Name: ______
City/State: ______
When? 19 ___ to 19 ___

8. Have you ever defaulted on any previous surety bonds (SBA or other) (either under this contracting concern's trade name or any other concern's of which you have been a principal)? ☐ Yes ☒ No
If "yes", detailed particulars are to be attached to all four (4) copies of this application form. Particulars should include at least the following: (1) Name of Surety; (2) Name of obligee; (3) SBG No. with suffix Number, if applicable (4) Value of Contract.; (5) Date of Default; (6) Status of Default/Claim, i.e., amount of loss to Surety, etc; (7) Contractor's narrative explanation as to reason for default and actions taken to meet the obligations to the Surety under term of the bond(s).

9. Applicant hereby authorizes any agent, broker, surety company or financial institution in possession of credit, financial or [illegible] information concerning the undersigned applicant and the applicant's business to release the [illegible] to [illegible] SBA may evaluate the same for the purpose of bond guarantee assistance. Applicant certifies that [illegible] submits to any agent, broker or surety company for their evaluation as to the bondability of this contractor is correct and accurate to the best of the contractor's knowledge.

10. Any intentionally false statement in this application or willful misrepresentation relative thereto is a violation of [illegible] may subject you to criminal and civil prosecution, 18 U.S.C. Sections 287, 371, 1001; 15 U.S.C. Section 645; [illegible] 231, carrying fines up to $10,000 and imprisonment up to five years.

11. [illegible] I hereby certify that all information presented herein is complete and accurate to the best of my knowledge. I further agree to notify SBA, in writing, of any fee(s) paid by me or my designee(s) to the Surety and/or it's representatives which are in excess of the fee structure noted in Paragraph 3, above, and specified in Paragraph 9, reverse side. (Attach a separate sheet, detailing amount of such excessive fee(s) and purpose thereof).

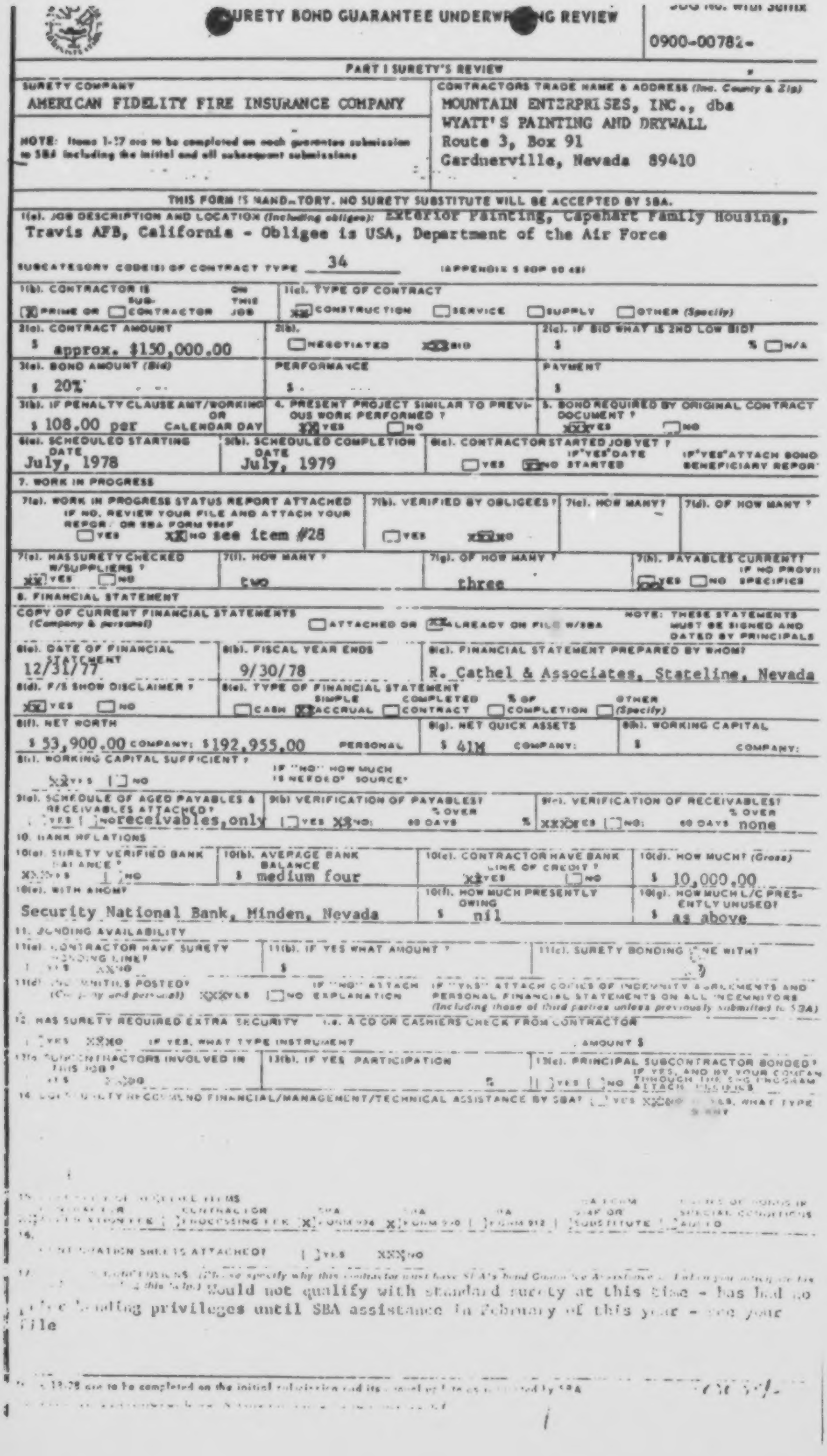
Signature (Applicant) ______ Date 5 / 23 / 78

Title: President

TO BE COMPLETED BY SBA
[illegible]
BY: (NAME)
SBG NO.

[illegible] OFFICE [illegible] COPY - SURETY
[illegible] OFFICE [illegible]

[illegible]



## SURETY BOND GUARANTEE UNDERWRITING REVIEW

SBG NO. WITH SUFFIX
0900-00782-

PART I SURETY'S REVIEW

| | |
|---|---|
| SURETY COMPANY<br>AMERICAN FIDELITY FIRE INSURANCE COMPANY<br>NOTE: Items 1-17 are to be completed on each guarantee submission to SBA including the initial and all subsequent submissions | CONTRACTORS TRADE NAME & ADDRESS (Inc. County & Zip)<br>MOUNTAIN ENTERPRISES, INC., dba<br>WYATT'S PAINTING AND DRYWALL<br>Route 3, Box 91<br>Gardnerville, Nevada 89410 |

THIS FORM IS MANDATORY. NO SURETY SUBSTITUTE WILL BE ACCEPTED BY SBA.

1(a). JOB DESCRIPTION AND LOCATION (Including obligee): Exterior Painting, Capehart Family Housing, Travis AFB, California - Obligee is USA, Department of the Air Force

SUBCATEGORY CODE(S) OF CONTRACT TYPE 34 (APPENDIX 5 SOP 50 45)

| | | | |
|---|---|---|---|
| 1(b). CONTRACTOR IS ON THIS JOB<br>☒ PRIME OR ☐ SUB-CONTRACTOR | 1(c). TYPE OF CONTRACT<br>☒ CONSTRUCTION ☐ SERVICE ☐ SUPPLY ☐ OTHER (Specify) | | |
| 2(a). CONTRACT AMOUNT<br>$ approx. $150,000.00 | 2(b).<br>☐ NEGOTIATED ☒ BID | 2(c). IF BID WHAT IS 2ND LOW BID?<br>$ % ☐ N/A | |
| 3(a). BOND AMOUNT (Bid)<br>$ 20% | PERFORMANCE<br>$ | PAYMENT<br>$ | |
| 3(b). IF PENALTY CLAUSE AMT/WORKING OR CALENDAR DAY<br>$ 108.00 per calendar day | 4. PRESENT PROJECT SIMILAR TO PREVIOUS WORK PERFORMED?<br>☒ YES ☐ NO | 5. BOND REQUIRED BY ORIGINAL CONTRACT DOCUMENT?<br>☒ YES ☐ NO | |
| 6(a). SCHEDULED STARTING DATE<br>July, 1978 | 6(b). SCHEDULED COMPLETION DATE<br>July, 1979 | 6(c). CONTRACTOR STARTED JOB YET?<br>☐ YES ☒ NO IF "YES" DATE STARTED | IF "YES" ATTACH BOND BENEFICIARY REPORT |

7. WORK IN PROGRESS

| | | | |
|---|---|---|---|
| 7(a). WORK IN PROGRESS STATUS REPORT ATTACHED IF NO, REVIEW YOUR FILE AND ATTACH YOUR REPORT OR SBA FORM 994F<br>☐ YES ☒ NO see item #28 | 7(b). VERIFIED BY OBLIGEES?<br>☐ YES ☒ NO | 7(c). HOW MANY?<br>- | 7(d). OF HOW MANY? |
| 7(e). HAS SURETY CHECKED W/SUPPLIERS?<br>☒ YES ☐ NO | 7(f). HOW MANY?<br>two | 7(g). OF HOW MANY?<br>three | 7(h). PAYABLES CURRENT? IF NO PROVIDE SPECIFICS<br>☒ YES ☐ NO |

8. FINANCIAL STATEMENT

COPY OF CURRENT FINANCIAL STATEMENTS (Company & personal) ☐ ATTACHED OR ☒ ALREADY ON FILE W/SBA NOTE: THESE STATEMENTS MUST BE SIGNED AND DATED BY PRINCIPALS

| | | | |
|---|---|---|---|
| 8(a). DATE OF FINANCIAL STATEMENT<br>12/31/77 | 8(b). FISCAL YEAR ENDS<br>9/30/78 | 8(c). FINANCIAL STATEMENT PREPARED BY WHOM?<br>R. Cathel & Associates, Stateline, Nevada | |
| 8(d). F/S SHOW DISCLAIMER?<br>☒ YES ☐ NO | 8(e). TYPE OF FINANCIAL STATEMENT<br>☐ CASH ☒ SIMPLE ACCRUAL ☐ COMPLETED CONTRACT ☐ % OF COMPLETION ☐ OTHER (Specify) | | |
| 8(f). NET WORTH<br>$ 53,900.00 COMPANY: $192,955.00 PERSONAL | | 8(g). NET QUICK ASSETS<br>$ 41M COMPANY: | 8(h). WORKING CAPITAL<br>$ COMPANY: |
| 8(i). WORKING CAPITAL SUFFICIENT?<br>☒ YES ☐ NO | IF "NO" HOW MUCH IS NEEDED? SOURCE? | | |
| 9(a). SCHEDULE OF AGED PAYABLES & RECEIVABLES ATTACHED?<br>☐ YES ☐ NO receivables only | 9(b) VERIFICATION OF PAYABLES?<br>☐ YES ☒ NO: % OVER 60 DAYS % | 9(c). VERIFICATION OF RECEIVABLES?<br>☒ YES ☐ NO: % OVER 60 DAYS none | |

10. BANK RELATIONS

| | | | |
|---|---|---|---|
| 10(a). SURETY VERIFIED BANK BALANCE?<br>☒ YES ☐ NO | 10(b). AVERAGE BANK BALANCE<br>$ medium four | 10(c). CONTRACTOR HAVE BANK LINE OF CREDIT?<br>☒ YES ☐ NO | 10(d). HOW MUCH? (Gross)<br>$ 10,000.00 |
| 10(e). WITH WHOM?<br>Security National Bank, Minden, Nevada | | 10(f). HOW MUCH PRESENTLY OWING<br>$ nil | 10(g). HOW MUCH L/C PRESENTLY UNUSED?<br>$ as above |

11. BONDING AVAILABILITY

| | | |
|---|---|---|
| 11(a). CONTRACTOR HAVE SURETY BONDING LINE?<br>☐ YES ☒ NO | 11(b). IF YES WHAT AMOUNT?<br>$ | 11(c). SURETY BONDING LINE WITH? |
| 11(d). INDEMNITIES POSTED? (Company and personal)<br>☒ YES ☐ NO | IF "NO" ATTACH EXPLANATION | IF "YES" ATTACH COPIES OF INDEMNITY AGREEMENTS AND PERSONAL FINANCIAL STATEMENTS ON ALL INDEMNITORS (Including those of third parties unless previously submitted to SBA) |

12. HAS SURETY REQUIRED EXTRA SECURITY i.e. A CD OR CASHIERS CHECK FROM CONTRACTOR
☐ YES ☒ NO IF YES, WHAT TYPE INSTRUMENT? , AMOUNT $

| | | |
|---|---|---|
| 13(a). SUBCONTRACTORS INVOLVED IN THIS JOB?<br>☐ YES ☒ NO | 13(b). IF YES PARTICIPATION<br>% | 13(c). PRINCIPAL SUBCONTRACTOR BONDED?<br>☐ YES ☐ NO IF YES, AND BY YOUR COMPANY THROUGH THE SBG PROGRAM ATTACH [illegible] |

14. DOES SURETY RECOMMEND FINANCIAL/MANAGEMENT/TECHNICAL ASSISTANCE BY SBA? ☐ YES ☒ NO IF YES, WHAT TYPE & WHY

15. [illegible] ITEMS
CONTRACTOR [illegible] FEE ☐ CONTRACTOR PROCESSING FEE ☒ SBA FORM 994 ☒ SBA FORM 990 ☐ SBA FORM 912 ☐ SBA FORM [illegible] OR SUBSTITUTE ☐ COPIES OF BONDS IF SPECIAL CONDITIONS ADDED

16. CONTINUATION SHEETS ATTACHED? ☐ YES ☒ NO

17. RECOMMENDATIONS (Please specify why this contractor must have SBA's bond Guarantee Assistance [illegible] this help) Would not qualify with standard surety at this time - has had no prior bonding privileges until SBA assistance in February of this year - see your file

Items 18-28 are to be completed on the initial submission and its renewal [illegible] by SBA

21(a). CONTRACTOR EVER FAILED TO COMPLETE JOB? ☐ YES ☐ NO IF "YES" ATTACH SPECIFICS

21(b). HAS CONTRACTOR EVER DEFAULTED ON A CONTRACT FORCING A SURETY TO SUFFER A LOSS? ☐ YES ☐ NO IF "YES" ATTACH SPECIFICS

22(a). CONTRACTOR HAVE ADEQUATE EQUIPMENT? ☐ YES ☐ NO

22(b). OWNED? ☐ YES ☐ NO

22(c). LEASED? ☐ YES ☐ NO

23. CONTRACTOR TAXES CURRENT? IF "NO" ATTACH SPECIFICS ☐ YES ☐ NO

24. CONTRACTOR INSURANCE COVERAGE SUFFICIENT? ☐ YES ☐ NO

25(a). CONTRACTOR PREVIOUSLY BONDED? ☐ YES ☐ NO

25(b). LARGEST AMOUNT BONDED? $ JOB: $ WORK PROGRAM

25(c). WITH WHOM?

25(d). IF CHANGE OF SURETY, WHY?

26. ATTACHED RESUME(S) OF OFFICERS, OWNERS AND/OR KEY EMPLOYEES ☐ YES ☐ NO

27(a). MANAGING AGENCY OF SURETY *(If applicable)* THE LEAVITT GROUP

27(b). MANAGING AGENCY'S EMPLOYER (IRS) I.D. 88-0085613

28. REMARKS/CONCLUSIONS Re work in progress: contractor has no large and/or commercial jobs in progress (due to continued inclement weather - 26 degrees today in Gardnerville!) - has eight custom home projects (painting); approximately $15,000.00 total work on hand - all unbonded - to be complete in two weeks

IN OUR OPINION THE PRINCIPAL APPEARS TO HAVE THE FINANCIAL/MANAGEMENT/TECHNICAL ABILITIES TO SUCCESSFULLY COMPLETE THIS CONTRACT, HOWEVER, WE FEEL THIS CONTRACTOR FALLS BELOW THE NORMAL UNDERWRITING STANDARD OF OUR COMPANY, AND WE WILL NOT ISSUE BONDS TO THIS CONTRACTOR WITHOUT THE SBA GUARANTEE.

SIGNATURE OF UNDERWRITER Doris Clark

DATE May 25, 1978

TYPED NAME Doris Clark

TELEPHONE NO. *(Inc. Area Code)* 702 -- 385-7195

TITLE OF UNDERWRITER Attorney-in-Fact

AGENCY NAME *(If applicable)* Clark-Leavitt Agency

ADDRESS OF UNDERWRITER P. O. Box 15350

CITY Las Vegas

STATE Nevada

ZIP 89114

DATE RECEIVED BY SBA MAY 30 1978

BY: *(Initials)*

PART B SURETY'S REVIEW — TO BE COMPLETED BY SBA

1. MEETS SBG SIZE STANDARDS ☑ YES ☐ NO

2. FINANCIAL/MANAGEMENT/TECHNICAL ASSISTANCE REQUESTED OR RECOMMENDED ☐ YES ☑ NO

2(a). BY WHOM?

2(b). WHAT TYPE?

2(c). SBA ACTION TAKEN

3(a). IF NECESSARY ASSISTANCE IS NOT READILY AVAILABLE IN GOVERNMENT HAVE YOU REFERRED APPLICANT TO FUNDED ASSISTANCE PROGRAMS, i.e. MINORITY CONTRACTORS ASSISTANCE PROJECT *(MCAP)*, ETC.? ☐ YES ☐ NO

3(b). IF YES NAME THE PROGRAM(S):

4. BASED ON THE UNDERWRITING DATA SUBMITTED:

4(a). THERE ☑ IS ☐ IS NOT REASON TO EXPECT SUCCESSFUL COMPLETION OF THE CONTRACT

4(b). THE COSTS ☐ DO NOT ☑ DO APPEAR TO BE REASONABLE IN ACCORDANCE WITH STD. SURETY INDUSTRY PRACTICES

5. IT HAS BEEN DETERMINED THAT THE REQUESTED BOND(S) ☑ IS ☐ IS NOT NECESSARY, REQUIRED BY THE CONTRACT DOCUMENT'S TERMS, AND THE SURETY HAS INDICATED THAT IT WILL NOT ISSUE THE BOND(S) WITHOUT THE SBA GUARANTEE. FURTHERMORE, NO ADVERSE DATA CONCERNING THE SURETY'S PREMIUM/FEE SCHEDULE WAS REVEALED IN THE CONTRACTOR'S APPLICATION *(SBA Form 994)*

6. ATTACHMENTS *(Check appropriate boxes)*

| | | | | | |
|---|---|---|---|---|---|
| | CONTINUATION SHEETS | | INDEMNITY AGREEMENT(S) | ☑ | SBA FORM 994 |
| ☑ | CONTRACTOR'S CURRENT BUSINESS FINANCIAL STATEMENT | | PERSONAL FINANCIAL STATEMENT(S) | ☑ | SBA FORM 912 |
| | RESUMES OF PRINCIPAL(S) OWNER(S) AND OR KEY EMPLOYEES | ☑ | SBA FORM 390 | | SBA FORM 994F 15M |

7. REMARKS/CONCLUSIONS

Normal painting contract.

8. APPLICANT'S TRADE NAME Wyatt's Painting — 0D1

9. RECOMMENDATION/ACTION

| APPROVE | DISAPPROVE | SIGNATURE | TITLE | DATE |
|---|---|---|---|---|
| ☒ | ☐ | Jeffery Johnston | SBS | 5/31/78 |
| ☑ | ☐ | | Chief, CED Division | 5/31/78 |
| ☐ | ☐ | | | |

CLARK - LEAVITT AGENCY
P. O. BOX 15350
LAS VEGAS, NEV. 89114

RE: WYATT'S PAINTING AND DRYWALL
SBG NO. 0900-00782 004 51

Gentlemen:

For your information, Wyatt's Painting and Drywall is the low bidder on the above, which was postponed to 6/13 from original bid date of 6/6, at approximately $143,750.00 - final bond will be issued shortly and reported to you in the usual manner.

Doris Clark

JUN 19 1978

U.S. SMALL BUSINESS ADMINISTRATION

## SURETY BOND GUARANTEE AGREEMENT

PART I

The Small Business Administration, an Agency of the United States Government, hereinafter called SBA, pursuant to the authority contained in Part B of Title IV of the Small Business Investment Act, as amended, 15 USC Sections 694a and b, and to the regulations issued pursuant thereto, and in consideration of Surety's payment of the SBA's guarantee fee and issuance of the bond(s) requested by the Principal, and in reliance upon the declarations contained in Part I and subject to the terms and conditions contained in Part II, agrees to guarantee the Surety against up to 90 percent of the loss it suffers as the result of the Principal's breach of the terms of the contract bonded.

| | |
|---|---|
| **Surety Name**<br>AMERICAN FIDELITY FIRE INSURANCE COMPANY | **Principal's Trade Name**<br>MOUNTAIN ENTERPRISES, INC., DBA<br>WYATT'S PAINTING AND DRYWALL |
| **Surety Underwriter's Name**<br>Doris Clark | **Principal's Trade Address:**<br>Street Route 3, Box 91 |
| **Principal's Name**<br>W. C. Wyatt | **City, State, Zip and County**<br>Gardnerville, Nevada 89410 |

A. DESCRIPTION OF NATURE, LOCATION, AMOUNT AND EXTENT OF WORK TO BE DONE ON:

(a) Contract
Exterior Painting, Capehart Family Housing, Travis AFB, California

(b) Obligee
USA, Department of the Air Force

IF SUBCONTRACT ON PUBLICLY-FINANCED PROJECT, SPECIFY BOTH PRIME CONTRACTOR AND PUBLIC SECTOR OBLIGEE

B. WHERE APPLICABLE THIS AGREEMENT CONFIRMS THE ORAL COMMITMENT MADE BY

| | | |
|---|---|---|
| Name of SBA Official | Of the SBA Office in (City and State) | |
| To: (Name of authorized representative for surety) | Of: (City & State) | On (Date) |

This confirmation is being submitted within 15 calendar days of oral commitment, as required by SBA regulations.

This Agreement shall take effect upon signing by the authorized SBA representative, and all terms and conditions inserted herein must be initialed by both SBA and Surety.

| | | |
|---|---|---|
| Signature of Surety's Authorized Representative: Doris Clark<br>Typed Name [illegible] Clark | Title<br>Atty-in-Fact | Date<br>[illegible] |
| SBA Signature<br>Typed Name<br>☐ Returned with special conditions (below)<br>Disposition: ☐ Approved ☐ Disapproved ☐ Returned/Withdrawn | Title<br>[illegible] | Date |

In witness thereof, the Small Business Administration has caused this guarantee to be executed this ______ day of ________ 19__ in accordance with published SBA regulations, SBA Guarantee Equals ______%.

Special Conditions By SBA Only ☐ Yes ☐ No (If "Yes", Specify)

| | | | |
|---|---|---|---|
| Surety Signature (For Special Conditions)<br>☐ Approve ☐ Decline | Date | SBA Signature (for Special condition(s), if approved by Surety) | Date |

PLEASE COMPLETE WHEN DATA IS AVAILABLE

Items 1-6 to be Completed for ALL Submissions

| | | |
|---|---|---|
| 1. Date Bids/Offers to be opened (If applic.) | 2. Estimated Contract Amounts | 3. Contract:<br>☐ Bid ☐ Negotiated |
| 4. Bonds Required<br>☐ Bid ☐ Payment ☐ Performance | 5. Bond Amount (%)<br>Bid Payment Performance | 6. Contract Awarded (If "yes", complete Items 7-14)<br>☑ Yes ☐ No |

Items 7-14 to be Completed Only for Contracts Awarded.

| | | |
|---|---|---|
| 7. Date Awarded<br>1/11/78 | 9. Amount of Contract<br>0143750.00 | 10. SBA Processing Fee Paid by Surety<br>$ [illegible] / [illegible] |
| 8. Bond Amounts<br>Bid $ Payment $71,875.00 Performance $143,750.00 | | 11. Premium Charged<br>$ 2,156.00 1.5 1431 |
| 12. Bond Numbers<br>Payment # 1577773-2 Performance # Same | | 13. Project for: ☒ Federal ☐ State ☐ Local<br>☐ Special District ☐ Private ☐ Other |

14. If bid bond, give BID SPREAD:

[illegible]

TO BE COMPLETED BY SBA

| | | |
|---|---|---|
| SBA Guarantee No.<br>[illegible] | Date Received<br>[illegible] 1 0 1978 | Typed Name |

3

*United Inspection Bureau, Inc.*
*Surety Bond Claims*

*15910 Venture Boulevard, Encino, California, 91436*
*telephone (213) 788-9420*

7-5-79

May 30, 1979

Mr. Sal Lauricella
Chief Underwriter
Surety Bond Guarantee
Underwriting Division
Small Business Administration
1441 L, N.W.
Washington, D.C. 20416

Re: ~~Mountain Enterprises~~ Wyatt Painting ?
Project: Cape Hart Housing, Traverse Air Force Base
Bond No: 04-714-1277732
SBG No: 0900-00782-004-51

Dear Mr. Lauricella:

The following is pursuant to required notification procedures.

Surety issued a Performance Bond in the amount of $143,750 and a Payment Bond in the amount of $143,750 on the above referenced project.

The Surety was notified by the project superintendent that the principal is filing bankruptcy. The principal has not responded to demand letters by the Surety or the obligee and Surety has been unable to make contact with the principal.

Due to the principal's nonresponsive position, the Surety commenced an investigation and ascertained that there is currently in excess of $11,000 owed for labor having been performed on the project to date; anticipated cost of $7,000 in labor expenses to complete the project; outstanding material claims against the project in the approximate sum of $25,000. The Surety is investigating the legitimacy of the material claims and is seeking, through the obligee, to verify the labor claims.

Surety has ascertained that the project is approximately 96.5% complete and that the project can be completed within two to three weeks. In view of the foregoing, the Surety is attempting to negotiate with the existing work crew to complete the project. Surety has ascertained that there are approximately $13,500 remaining in contract funds, however, the principal had made an assignment of all contract proceeds to a bank. The bank is asserting a claim in excess of $1,300 at this time. It is anticipated that the Surety will, upon the completion of the project, be able to recapture approximately $12,000 in contract funds without any dispute from the bank.

It is recommended that a reserve in the amount of $33,000 be established at this time to cover labor claimants, material claimants, completion costs, investigation costs and attorneys fees. Should the status of this matter change, or additional information become available not known at this time, you will be further updated.

A review of the principal's financial statement reveals that at the time of submission of the financial statement, the principal allegedly held substantial real estate holdings in California. The Surety is currently undertaking asset location proceedings to determine if there are any assets owned by the principal which would be a basis for a possible recovery of the Surety's losses. As soon as the results of the asset location are known, you will be further advised.

Your courtesy and cooperation in the handling of this matter is greatly appreciated.

Sincerely yours,

Joseph R. Cunningham
Claims Attorney

cc: American Fidelity Fire Ins. Co.
Attorney in Fact
SBA Regional Office

JRC/wsn

## MOUNTAIN ENTERPRISES INC
## STATEMENT OF FINANCIAL CONDITION
## FEBRUARY 20, 1979

(PREPARED WITHOUT REVIEW)

### ASSETS

| | | |
|---|---|---|
| CURRENT ASSETS | | |
| Cash in Bank | 37,864 | |
| Advances | 995 | |
| Inventory | 116,836 | |
| (LSA) Retention | 28,740 | |
| TOTAL, CURRENT, ASSETS | | 184,435 |
| FIXED ASSETS | | |
| Machinery and Equipment | 83,996 | |
| Vehicles | 19,556 | |
| Furniture and Fixtures | 11,754 | |
| | 115,306 | |
| Less accumulated depreciation | 13,567 | |
| TOTAL FIXED ASSETS | | 101,739 |
| TOTAL ASSETS | | 286,274 |

### LIABILITIES & STOCKHOLDER SEQUIT

| | | |
|---|---|---|
| CURRENT LIABILITIES | | |
| Accounts Payable | 20,084 | |
| Accrued Federal Income Taxes | 99 | |
| * Notes Payable | 44,308 | |
| TOTAL CURRENT LIABILITIES | | 64,491 |
| STOCKHOLDERS' EQUITY | | |
| Common Stock $100 Par Value Authorized 750 Shares - Issued and Outstanding 356 Shares | 35,600 | |
| Retained Earnings | 186,183 | |
| TOTAL STOCKHOLDERS EQUITY | | 221,783 |
| TOTAL LIABILITIES & STOCKHOLDERS EQUITY | | 286,274 |

① Nev. Nat'l - Carson City
② Wells Fargo, Fairfield

* 30m to stockholder
5m - Wells Fargo Bank } due 3/31
6m - Nev. Natl Bank } due 2/28

*R. H. (Red) Cathell & Assoc.*
P.O. Box 3996 588-3333
Stateline, Nevada 89449

February 14, 1979

Mr. and Mrs. William Wyatt
504 Haywood Way
Fairfield, Calif. 94533

I have prepared without review the accompanying Statement of Net Assets of MR. AND MRS. WILLIAM WYATT as of February 14, 1979.

I have not reviewed the above financial statement and accordingly express no opinion thereon.

R.H. (RED) CATHELL & ASSOC.

RHC/lw

MR. AND MRS. WILLIAM WYATT
STATEMENT OF NET ASSETS
FEBRUARY 14, 1979
(PREPARED WITHOUT REVIEW)

| ASSETS | COST OR ESTIMATED COST | ESTIMATED FAIRMARKET VALUE |
|---|---|---|
| CASH | | |
| Cash on Hand | $ 780 | $ 780 |
| ① Cash in Bank | 17,345 | 17,345 |
| ACCOUNTS RECEIVABLE | | |
| Notes receivable | 2,500 | 2,500 |
| INVESTMENTS | | |
| Common Stock 100% Equity<br>Mt. Enterprises | 35,600 | 35,600 |
| REAL ESTATE | | |
| Land and residence - El Centro - 13 homes ② | 112,000 | 465,000 ③ |
| Land and residence - Gardnerville | 55,000 | 80,000 |
| OTHER ASSETS | | |
| Household furnishings (plus antiques) | 90,000 | 112,000 |
| Cash surrender value of life ins. | 10,000 | 10,000 |
| TOTAL ASSETS | 323,225 | 723,225 |

LIABILITIES AND PERSONAL EQUITY

| | | |
|---|---|---|
| REAL ESTATE | | |
| Land and residence | 10,000 | 10,000 El Centro |
| Land and residence | 55,000 | 55,000 Gardnerville |
| OTHER LIABILITIES | | |
| Various current debts | 4,425 | 4,425 |
| TOTAL LIABILITIES | 69,425 | 69,425 |
| PERSONAL EQUITY | | |
| Wyatt-Equity 2-14-79 | 253,800 | 653,800 |
| TOTAL LIABILITIES AND PERSONAL EQUITY | 323,225 | 723,225 |

Large [illegible]

② 1600 monthly rental income

③ 565 m Current appraisal

5

U.S. SMALL BUSINESS ADMINISTRATION
APPLI[illegible] FOR SURETY BOND GUARANTEE[illegible]ANCE

**TO BE COMPLETED BY PRINCIPAL**

TRADE NAME OF PRINCIPAL: MOUNTAIN ENTERPRISES, INC., dba WYATT'S PAINTING AND DRYWALL

PRINCIPAL'S HOME ADDRESS, STREET, CITY AND STATE (Include ZIP)
Route 3, Box 91
Gardnerville, Nevada 89410

PRINCIPAL'S BUSINESS ADDRESS, STREET, CITY AND STATE (Include COUNTY AND ZIP)
Same as above

PRINCIPAL'S EMPLOYER ID NUMBER: 88-0144634

**TO BE COMPLETED BY BROKER/AGENT (Producer)**

NAME OF SURETY: AMERICAN FIDELITY FIRE INSURANCE COMPANY

NAME OF BROKER/AGENT (Producer): CLARK-LEAVITT AGENCY

BROKER/AGENT (Producer's) STREET, CITY AND STATE (Include COUNTY AND ZIP)
P. O. Box 15350,
Las Vegas, Clark, Nevada 89114

BROKER/AGENT (Producer's) TELEPHONE NUMBER (Include Area Code): 702 -- 385-7195

BROKER/AGENT (Producer's) EMPLOYER ID NUMBER: 88-0149065

1. Applicant hereby states and affirms the following: new venture as of 10/1/77; volume as of 7/31/78 was $160,835.00

a. The annual gross receipts of my business (including affiliates, as set forth in Part 121 of SBA's Rules and Regulations) during the past fiscal year was $ see above , or, as annually averaged over the past 3 fiscal years, was $ ________ . (to the nearest hundreds). If there are affiliates, attach an explanation sheet, delineating annual gross receipts of each as their interests appear. If there are stockholders, attach an explanation sheet specifying what their shares of the organization(s) are.

Type of business: ☐ Proprietorship, ☐ Partnership, ☒ Corporation.
Year Business Formed: 1977 Joint Venture ☐ Yes ☒ No

b. A bid, payment or performance bond is required on the following project in order for me to serve as a ☒ primary contractor or ☐ subcontractor thereon.

c. Contractor certifies having attempted (and failed) to obtain the required bonds without the SBA's guarantee; furthermore, the contractor certifies being aware that some sureties charge higher premium rates for bonds than others do, in accordance with premium rate schedules filed in various States.

d. (1) Brief description of this contract work: exterior painting, military family housing and garages
(2) Estimated time required for completion: 12 (months) Contract have Penalty Clause? ☒ Yes ☐ No.
If "yes", how much? $ 70 per calendar or wkg. day.
(3) Anticipated project start date: mo. 10 day ___ yr. 78 (4) Projected completion date: mo. 10 day ___ yr. 79
(5) Project Location: Vallejo, California (6) Name of ☒ obligee or ☐ Prime Contractor: USA - DEPT. OF NAVY - MARE ISLAND

e. Approximate value of contract: $ 120,000.00

f. Applicant, in consideration of assistance from the SBA, herewith agrees it will comply with the nondiscrimination requirements of Title 13, Code of Federal Regulations, Part 112 and Part 113.

g. SBA is authorized to request this information under Executive Order 11625. It will be used only for statistical purposes. You are not required to disclose this information. Failure to do so will not affect your application.
(1) Principal is a ☒ Veteran ☐ Vietnam-ERA Veteran or ☐ Non Veteran (Check one)
(2) Principal is a ☒ Male ☐ Female
(3) Principal is a (0) ☐ Black, (1) ☐ Puerto Rican, (2) ☐ American Indian, (3) ☐ Hispanic (Includes Mexican-American, Cuban, Central or South American or others of Spanish Descent, (4) ☐ Asian (Includes persons of Chinese, Japanese, Korean, and Filipino Descent. Also, native Hawaiians, Indonesians, Samoans, Polynesians and Micronesians, (5) ☐ Eskimos and Aleuts, (6) ☐ Undetermined, (7) ☒ Others-including Caucasians.

2. The date, time and place of the bid opening is as follows: (if applicable):
Date August 8, 1978 | Time ________ | Place Mare Island, near Vallejo, California

3. I have read the "Contractor's Processing Fee" section (reverse side) and agree to abide by this fee schedule, PROVIDED I receive the contract sought and SBA extends its bond guarantee. I also agree to pay the contractor's SBA's processing fee to my Agent/Broker in accordance with Paragraph 9 reverse side.

4. I ☒ do not have an SBA Loan. I ☐ had a previous SBA Loan. I ☐ do have an SBA Loan through the SBA Office in ________ with a balance of $ ________ as of (Date) ________ Loan No. ________

5. I ☐ am ☒ am not an SBA 8(a) Qualified Contractor (Approved business plan on file)
This bond application ☐ does ☒ does not pertain to an 8(a) contract

6. I do ☐ or do not ☒ request Management Assistance.
I have ☐ or have not ☒ previously received SBA Management Assistance.

7. I ☒ have ☐ have not received previous SBA bond guarantee, either under this trade name or another
If under another trade name, specify:
Trade Name:
City/State:
When? 19 ___ to 19 ___

8. Have you ever defaulted on any previous surety bonds (SBA or other) (either under this contracting concern's trade name or [illegible] of which you have been a principal)? ☐ Yes ☒ No
If "yes", [illegible] particulars are to be attached to all four (4) copies of this application form. Particulars should [illegible] the following: (1) Name of Surety; (2) Name of obligee; (3) SBG No. with suffix Number, if applicable (4) Value of Contracts; (5) Date of Default; (6) Status of Default/Claim, i.e., amount of loss to Surety, etc; (7) Contractor's narrative explanation as to reason for default and actions taken to meet the obligations to the Surety under term of the bond(s).

9. [illegible] authorizes any agent, broker, surety company or financial institution in possession of credit, financial [illegible] information concerning the undersigned applicant and the applicant's business to release the same to SBA, [illegible] SBA may evaluate the same for the purpose of bond guarantee assistance. Applicant certifies that any [illegible] its to any agent, broker or surety company for their evaluation as to the bondability of this contractor [illegible] is correct and accurate to the best of the contractor's knowledge.

10. [illegible] false statement in this application or willful misrepresentation relative thereto is a violation of federal [illegible] subject you to criminal and civil prosecution, 18 U.S.C. Sections 287, 371, 1001; 15 U.S.C. Section 645; [illegible] carrying fines up to $10,000 and imprisonment up to five years.

11. [illegible] hereby certify that all information presented herein is complete and accurate to the best of my knowledge. [illegible] to notify SBA, in writing, of any fee(s) paid by me or my designee(s) to the Surety and/or it's representative [illegible] in excess of the fee structure noted in Paragraph 3, above, and specified in Paragraph 9, reverse side. [illegible] separate sheet, detailing amount of such excessive fee(s) and purpose thereof).

[illegible] (Applicant) ________ Date 8 / 2 / 78

[illegible]

TO BE COMPLETED BY SBA

BY: [illegible]

CCS

U.S. SMALL BUSINESS ADMINISTRATION

**SURETY BOND GUARANTEE UNDERWRITING REVIEW**

SBG No. with Suffix

0900-90782-

PART I SURETY'S REVIEW

SURETY COMPANY: AMERICAN FIDELITY FIRE INSURANCE COMPANY

NOTE: Items 1-17 are to be completed on each guarantee submission to SBA including the initial and all subsequent submissions

CONTRACTORS TRADE NAME & ADDRESS (Inc. County & Zip)

MOUNTAIN ENTERPRISES, INC., DBA
WYATT'S PAINTING AND DRYWALL
Route 3, Box 91
Gardnerville, Nevada 89410

THIS FORM IS MANDATORY. NO SURETY SUBSTITUTE WILL BE ACCEPTED BY SBA.

1(a). JOB DESCRIPTION AND LOCATION (Including obligee): Exterior painting, military family housing units and garages, Mare Island, Vallejo, California - Obligee is USA, Department of the Navy

SUBCATEGORY CODE(S) OF CONTRACT TYPE 34 (APPENDIX 5 SOP 50 45)

1(b). CONTRACTOR IS ON THIS JOB ☒ PRIME OR ☐ SUB-CONTRACTOR

1(c). TYPE OF CONTRACT ☒ CONSTRUCTION ☐ SERVICE ☐ SUPPLY ☐ OTHER (Specify)

2(a). CONTRACT AMOUNT $ approx. $120,000

2(b). ☐ NEGOTIATED ☒ BID

2(c). IF BID WHAT IS 2ND LOW BID? $ % ☐ N/A

3(a). BOND AMOUNT (P's) $ 20%

PERFORMANCE $

PAYMENT $

3(b). IF PENALTY CLAUSE AMT/WORKING OR CALENDAR DAY $ 70.00

4. PRESENT PROJECT SIMILAR TO PREVIOUS WORK PERFORMED? ☒ YES ☐ NO

5. BOND REQUIRED BY ORIGINAL CONTRACT DOCUMENT? ☒ YES ☐ NO

6(a). SCHEDULED STARTING DATE October, 1978

6(b). SCHEDULED COMPLETION DATE October, 1979

6(c). CONTRACTOR STARTED JOB YET? ☐ YES ☒ NO IF "YES" DATE STARTED IF "YES" ATTACH BOND BENEFICIARY REPORTS

7. WORK IN PROGRESS

7(a). WORK IN PROGRESS STATUS REPORT ATTACHED IF NO, REVIEW YOUR FILE AND ATTACH YOUR REPORT OR SBA FORM 994F ☐ YES ☒ NO see item 28

7(b). VERIFIED BY OBLIGEES? ☐ YES ☒ NO

7(c). HOW MANY? NA

7(d). OF HOW MANY? NA

7(e). HAS SURETY CHECKED W/SUPPLIERS? ☒ YES ☐ NO

7(f). HOW MANY? two

7(g). OF HOW MANY? three

7(h). PAYABLES CURRENT? IF NO PROVIDE SPECIFICS ☒ YES ☐ NO

8. FINANCIAL STATEMENT

COPY OF CURRENT FINANCIAL STATEMENTS (Company & personal) ☐ ATTACHED OR ☐ ALREADY ON FILE W/SBA FORWARDING UNDER SEPARATE COVER.... NOTE: THESE STATEMENTS MUST BE SIGNED AND DATED BY PRINCIPALS

8(a). DATE OF FINANCIAL STATEMENT 7/31/78

8(b). FISCAL YEAR ENDS 9/30/78

8(c). FINANCIAL STATEMENT PREPARED BY WHOM? Richard Cathell, Stateline, Nevada

8(d). F/S SHOW DISCLAIMER? ☒ YES ☐ NO

8(e). TYPE OF FINANCIAL STATEMENT ☐ CASH ☒ SIMPLE ACCRUAL ☐ COMPLETED CONTRACT ☐ % OF COMPLETION ☐ OTHER (Specify)

8(f). NET WORTH $ 92,085 COMPANY; $ 300,955 PERSONAL

8(g). NET QUICK ASSETS $ 39M COMPANY:

8(h). WORKING CAPITAL $ COMPANY:

8(i). WORKING CAPITAL SUFFICIENT? ☒ YES ☐ NO IF "NO" HOW MUCH IS NEEDED? SOURCE?

9(a). SCHEDULE OF AGED PAYABLES & RECEIVABLES ATTACHED? ☒ YES ☐ NO

9(b). VERIFICATION OF PAYABLES? ☐ YES ☒ NO: % OVER 60 DAYS %

9(c). VERIFICATION OF RECEIVABLES? ☐ YES ☒ NO: % OVER 60 DAYS %

10. BANK RELATIONS

10(a). SURETY VERIFIED BANK BALANCE? ☒ YES ☐ NO

10(b). AVERAGE BANK BALANCE $ high four

10(c). CONTRACTOR HAVE BANK LINE OF CREDIT? ☒ YES ☐ NO

10(d). HOW MUCH? (Gross) $ 10M

10(e) WITH WHOM? Security National Bank, Minden, Nevada

10(f). HOW MUCH PRESENTLY OWING $ 10M

10(g). HOW MUCH L/C PRESENTLY UNUSED? $ none

11. BONDING AVAILABILITY

11(a). CONTRACTOR HAVE SURETY BONDING LINE? ☐ YES ☒ NO

11(b). IF YES WHAT AMOUNT? $

11(c). SURETY BONDING LINE WITH?

11(d). INDEMNITIES POSTED? (Company and personal) ☒ YES ☐ NO IF "NO" ATTACH EXPLANATION IF "YES" ATTACH COPIES OF INDEMNITY AGREEMENTS AND PERSONAL FINANCIAL STATEMENTS ON ALL INDEMNITORS (Including those of third parties unless previously submitted to SBA)

12. HAS SURETY REQUIRED EXTRA SECURITY i.e. A CD OR CASHIERS CHECK FROM CONTRACTOR

☐ YES ☒ NO IF YES; WHAT TYPE INSTRUMENT ; AMOUNT $

13(a). SUBCONTRACTORS INVOLVED IN THIS JOB? ☐ YES ☒ NO

13(b). IF YES PARTICIPATION material approx. 25% %

13(c). PRINCIPAL SUBCONTRACTOR BONDED? ☐ YES ☐ NO IF YES, AND BY YOUR COMPANY THROUGH THE SBG PROGRAM ATTACH SPECIFICS

14. [illegible] SURETY RECOMMEND FINANCIAL/MANAGEMENT/TECHNICAL ASSISTANCE BY SBA? ☐ YES ☒ NO IF YES, WHAT TYPE & WHY

15. [illegible] OF REQUIRED ITEMS ☒ CONTRACTOR CERTIFICATION FEE ☐ CONTRACTOR PROCESSING FEE ☒ SBA FORM 994 ☒ SBA FORM 990 ☐ SBA FORM 912 ☐ SBA FORM 994F OR SUBSTITUTE ☐ COPIES OF [illegible] IF SPECIAL CONDITIONS ADDED

16. [illegible] SHEETS ATTACHED? ☐ YES ☒ NO

17. [illegible] CONCLUSIONS. (Please specify why this contractor must have SBA's Bond Guarantee Assistance and when [illegible] this help.)

Would not yet qualify with standard surety - no bonding prior to February, 1978 - will attempt to qualify with standard company through local agent after completion of 9/30/78 year-end statements....

Items 18-23 are to be completed on the initial submission and [illegible] by SBA

21(a). CONTRACTOR EVER FAILED TO COMPLETE JOB? ☐ YES ☐ NO IF "YES" ATTACH SPECIFICS

21(b). HAS CONTRACTOR EVER DEFAULTED ON A CONTRACT FORCING A SURETY TO SUFFER A LOSS? ☐ YES ☐ NO IF "YES" ATTACH SPECIFICS

22(a). CONTRACTOR HAVE ADEQUATE EQUIPMENT? ☐ YES ☐ NO

22(b). OWNED? ☐ YES ☐ NO

22(c). LEASED? ☐ YES ☐ NO

23. CONTRACTOR TAXES CURRENT? IF "NO" ATTACH SPECIFICS ☐ YES ☐ NO

24. CONTRACTOR INSURANCE COVERAGE SUFFICIENT? ☐ YES ☐ NO

25(a). CONTRACTOR PREVIOUSLY BONDED? ☐ YES ☐ NO

25(b). LARGEST AMOUNT BONDED? $ JOB: $ - WORK PROGRAM

25(c). WITH WHOM?

25(d). IF CHANGE OF SURETY, WHY?

26. ATTACHED RESUME(S) OF OFFICERS, OWNERS AND/OR KEY EMPLOYEES ☐ YES ☐ NO

27(a). MANAGING AGENCY OF SURETY *(If applicable)*
THE LEAVITT GROUP

27(b). MANAGING AGENCY'S EMPLOYER *(IRS)* I.D.
88-0085613

28. REMARKS/CONCLUSIONS Re work in progress: Contractor has 25M miscellaneous, small interior painting jobs in progress; has not yet started $143,750 job at Travis AFB (seeSBG 0900-00782-004-51).

IN OUR OPINION THE PRINCIPAL APPEARS TO HAVE THE FINANCIAL/MANAGEMENT/TECHNICAL ABILITIES TO SUCCESSFULLY COMPLETE THIS CONTRACT, HOWEVER, WE FEEL THIS CONTRACTOR FALLS BELOW THE NORMAL UNDERWRITING STANDARD OF OUR COMPANY, AND WE WILL NOT ISSUE BONDS TO THIS CONTRACTOR WITHOUT THE SBA GUARANTEE.

SIGNATURE OF UNDERWRITER: Doris Clark

DATE: August 3, 1978

TYPED NAME: Doris Clark

TELEPHONE NO. *(Inc. Area Code)*: 702 -- 385-7195

TITLE OF UNDERWRITER: Attorney-in-Fact

AGENCY NAME *(If applicable)*: Clark-Leavitt Agency

ADDRESS OF UNDERWRITER: P. O. Box 15350

CITY: Las Vegas

STATE: Nevada

ZIP: 89114

DATE RECEIVED BY SBA:

BY: *(Initials)*

PART II SURETY'S REVIEW — TO BE COMPLETED BY SBA

1. MEETS SBG SIZE STANDARDS ☑ YES ☐ NO

2. FINANCIAL/MANAGEMENT/TECHNICAL ASSISTANCE REQUESTED OR RECOMMENDED ☐ YES ☑ NO

2(a). BY WHOM?

2(b). WHAT TYPE?

2(c). SBA ACTION TAKEN

3(a). IF NECESSARY ASSISTANCE IS NOT READILY AVAILABLE IN GOVERNMENT HAVE YOU REFERRED APPLICANT TO FUNDED ASSISTANCE PROGRAMS, i.e. MINORITY CONTRACTORS ASSISTANCE PROJECT *(MCAP)*, ETC.? ☐ YES ☐ NO

3(b). IF YES NAME THE PROGRAM(S):

4. BASED ON THE UNDERWRITING DATA SUBMITTED:

4(a). THERE ☑ IS ☐ IS NOT REASON TO EXPECT SUCCESSFUL COMPLETION OF THE CONTRACT

4(b). THE COSTS ☐ DO NOT ☑ DO APPEAR TO BE REASONABLE IN ACCORDANCE WITH STD. SURETY INDUSTRY PRACTICES

5. IT HAS BEEN DETERMINED THAT THE REQUESTED BOND(S) ☑ IS ☐ IS NOT NECESSARY, REQUIRED BY THE CONTRACT DOCUMENT'S TERMS, AND THE SURETY HAS INDICATED THAT IT WILL NOT ISSUE THE BOND(S) WITHOUT THE SBA GUARANTEE. FURTHERMORE, NO ADVERSE DATA CONCERNING THE SURETY'S PREMIUM/FEE SCHEDULE WAS REVEALED IN THE CONTRACTOR'S APPLICATION *(SBA Form 994)*

6. ATTACHMENTS *(Check appropriate boxes)*

| | | | | | |
|---|---|---|---|---|---|
| | CONTINUATION SHEETS | | INDEMNITY AGREEMENT(S) | ✓ | SBA FORM 994 |
| ✓ | CONTRACTOR'S CURRENT BUSINESS FINANCIAL STATEMENT | | PERSONAL FINANCIAL STATEMENT(S) | ✓ | SBA FORM 912 |
| ✓ | RESUMES OF PRINCIPAL(S) OWNER(S) AND OR KEY EMPLOYEES | ✓ | SBA FORM 990 | | SBA FORM 994F 1440 |

7. REMARKS/CONCLUSIONS

8. PRINCIPAL'S TRADE NAME Hyatt's Painting

9. RECOMMENDATION/ACTION

| APPROVE | DISAPPROVE | SIGNATURE | TITLE | DATE |
|---|---|---|---|---|
| ✓ | ☐ | | SRS | [illegible] |
| ✓ | ☐ | | Chief, CED Division | [illegible] |

## U.S. SMALL BUSINESS ADMINISTRATION
## SURETY BOND GUARANTEE AGREEMENT

PART I

The Small Business Administration, an Agency of the United States Government, hereinafter called SBA, pursuant to the authority contained in Part B of Title IV of the Small Business Investment Act, as amended, 15 USC Sections 694a and b, and to the regulations issued pursuant thereto, and in consideration of Surety's payment of the SBA's guarantee fee and issuance of the bond(s) requested by the Principal, and in reliance upon the declarations contained in Part I and subject to the terms and conditions contained in Part II, agrees to guarantee the Surety against up to 90 percent of the loss it suffers as the result of the Principal's breach of the terms of the contract bonded.

| | |
|---|---|
| Surety Name<br>[illegible] | Principal's Trade Name<br>MOUNTAIN ENTERPRISES, INC., dba<br>WATT'S PAINTING AND DRYWALL |
| Surety Underwriter's Name<br>[illegible] | Principal's Trade Address<br>Street [illegible] |
| Principal's Name<br>[illegible] | City, State, Zip and County<br>[illegible] 89410 |

A. DESCRIPTION OF NATURE, LOCATION, AMOUNT AND EXTENT OF WORK TO BE DONE ON:

(a) Contract
Exterior Painting [illegible]

(b) Obligee
[illegible] Department of the Navy, Mare Island [illegible]

IF SUBCONTRACT ON PUBLICLY-FINANCED PROJECT, SPECIFY BOTH PRIME CONTRACTOR AND PUBLIC SECTOR OBLIGEE

B. WHERE APPLICABLE THIS AGREEMENT CONFIRMS THE ORAL COMMITMENT MADE BY

| | | |
|---|---|---|
| Name of SBA Official | Of the SBA Office in (City and State) | |
| To: (Name of authorized representative for surety) | Of: (City & State) | On (Date) |

This confirmation is being submitted within 15 calendar days of oral commitment, as required by SBA regulations.

This Agreement shall take effect upon signing by the authorized SBA representative, and all terms and conditions inserted herein must be initialed by both SBA and Surety.

| | | |
|---|---|---|
| Signature of Surety's Authorized Representatives<br>Typed Name | Title | Date |
| SBA Signature<br>Typed Name ☐ Returned with special conditions (below)<br>Disposition: ☐ Approved ☐ Disapproved ☐ Returned/Withdrawn | Title | Date<br>8-4-7 |

In witness thereof, the Small Business Administration has caused this guarantee to be executed this ______ day of ______, in accordance with published SBA regulations, SBA Guarantee Equals ______%.

Special Conditions By SBA Only ☐ Yes ☐ No (If "Yes", Specify)

| | | | |
|---|---|---|---|
| Surety Signature (For Special Conditions)<br>☐ Approve ☐ Decline | Date | SBA Signature (for Special condition(s), if approved by Surety) | Date |

PLEASE COMPLETE WHEN DATA IS AVAILABLE

Items 1-6 to be Completed for ALL Submissions

| | | |
|---|---|---|
| 1. Date and time bids to be opened (if applic.) | 2. Estimated Contract Amount | 3. Contract:<br>☒ Bid ☐ Negotiated |
| 4. Bonds Required<br>☐ Bid ☐ Payment ☐ Performance | 5. Bond Amount (%)<br>209 Bid Payment Performance | 6. Contract Awarded (if "yes", complete Items 7-14)<br>☐ Yes ☐ No |

Items 7-14 to be Completed Only for Contracts Awarded.

| | | |
|---|---|---|
| 7. [illegible]<br>[illegible] 18 | 8. Amount of Contract<br>120 | 9. SBA Processing Fee From Contractor<br>$ |
| 10. Bond Amounts<br>Bid $ Payment $ Performance $ | | 11. Premium Charged<br>$ % |
| 12. Bond Numbers<br>Payment # Performance # | | 13. Project for: ☐ Federal ☐ State ☐ Local<br>☐ Special District ☐ Private ☐ Other |

14. If [illegible] Bid, BID SPREAD:

$ ______ $ ______ $ ______

TO BE COMPLETED BY SBA

| | | |
|---|---|---|
| [illegible] SUFFIX<br>[illegible] 5 | Date Received<br>FEB [illegible] | Sys. Name |

# U.S. SMALL BUSINESS ADMINISTRATION
# SURETY BOND GUARANTEE AGREEMENT

**PART I**

The Small Business Administration, an Agency of the United States Government, hereinafter called SBA, pursuant to the authority contained in Part B of Title IV of the Small Business Investment Act, as amended, 15 USC Sections 694a and b, and to the regulations issued pursuant thereto, and in consideration of Surety's payment of the SBA's guarantee fee and issuance of the bond(s) requested by the Principal, and in reliance upon the declarations contained in Part I and subject to the terms and conditions contained in Part II, agrees to guarantee the Surety against up to 90 percent of the loss it suffers as the result of the Principal's breach of the terms of the contract bonded.

Surety Name: [illegible] ITY FIRE INSURANCE COMPANY

Principal's Trade Name: MOUNTAIN ENTERPRISES, INC., dba WYATT'S PAINTING AND DRYWALL

Surety Underwriter's Name: Doris Clark

Principal's Trade Address:
Street: Route 3, Box 91

Principal's Name: W. C. "Bud" Wyatt

City, State, Zip and County: Gardnerville, Nevada 89410

**A. DESCRIPTION OF NATURE, LOCATION, AMOUNT AND EXTENT OF WORK TO BE DONE ON:**

(a) Contract: Interior painting, military family housing units and garages, Mare Island, California

(b) Obligee: [illegible] of the Navy, Mare Island

**IF SUBCONTRACT ON PUBLICLY-FINANCED PROJECT, SPECIFY BOTH PRIME CONTRACTOR AND PUBLIC SECTOR OBLIGEE**

**B. WHERE APPLICABLE THIS AGREEMENT CONFIRMS THE ORAL COMMITMENT MADE BY**

Name of SBA Official:

Of the SBA Office in (City and State):

To: (Name of authorized representative for surety)

Of: (City & State)

On (Date)

This confirmation is being submitted within 15 calendar days of oral commitment, as required by SBA regulations.

This Agreement shall take effect upon signing by the authorized SBA representative, and all terms and conditions inserted herein must be initialed by both SBA and Surety.

Signature of Surety's Authorized Representative:

Title

Date

Typed Name

SBA Signature

Typed Name

Title

Date

Disposition: [ ] Approved [ ] Disapproved ☐ Returned with special conditions (below) ☐ Returned/Withdrawn

[illegible] Small Business Administration has caused this guarantee to be executed this ____ day of ________ 19__

[illegible] SBA regulations, SBA Guarantee Equals ________%.

Special Conditions By SBA Only ☐ Yes ☐ No (If "Yes", Specify)

SEP 1 1 1978

[illegible] Special Conditions) | Date | SBA Signature (for Special condition(s), if approved by Surety) | Date

[ ] [illegible] [ ] Decline

**PLEASE COMPLETE WHEN DATA IS AVAILABLE**

[illegible] ALL [illegible]

1. [illegible]

2. Estimated Contract Amount:

3. [illegible] [ ] Bid [illegible]

5. Bond Amount (s): Bid Payment Performance

6. [illegible] [ ] Yes [illegible]

7. [illegible]

8. Amount of Contract [illegible]

9. SBA [illegible] $ [illegible]

Payment $ [illegible] Performance $ 116,[illegible]

11. Premium Charged $ [illegible] / $ [illegible]

Performance $ [illegible]

13. Project for: [ ] Federal [ ] State [ ] Special District [ ] Private

TO BE COMPLETED BY SBA

Date Received

6 Call file

United Inspection Bureau, Inc.
*Surety Bond Claims*

*15910 Ventura Boulevard, Encino, California, 9143*
*telephone (213) 788-942*

July 3, 1979

Mr. Sal Lauricella
Chief Underwriter
Surety Bond Guarantee
Underwriting Division
Small Business Administration
1441 L, N.W.
Washington, D.C. 20416

Re: ~~Mountain Enterprises~~ Wyatt Enterprises
Project: Exterior painting Military Family Housing - Mare Island Naval Base
Bond No: 04-714-1277759
SBG No: 0900-00782-005-53

DEFAULT NOTIFICATION - INITIAL STATUS REPORT

Dear Mr. Lauricella:

The following is pursuant to required notification procedures.

The Surety issued a Performance Bond in the amount of $116,998 and a Payment Bond in the amount of $58,499 on the above referenced project.

The Surety was notified by the project superintendent, the principal is filing bankruptcy. The principal has not responded to Demand Letters by the Surety, or the obligee, and the Surety has been unable to make contact with the principal.

Due to the principal's non-responsive position, the Surety commenced an investigation and ascertained that the project is approximately 75% completed, which will require the expenditure of approximately $36,000 for labor and an additional $11,000 for material to complete the project. Additionally, there is one known claimant who performed a portion of the work as a sub-contractor and is allegedly owed $17,600.

There are approximately $29,000 in contract funds remaining, including retention.

The Surety attempted to obtain reasonable completion bids from outside contractors, however, the lowest completion estimate was in the range of $85,000. In view of this, Surety is undertaking completion of the project, utilizing the existing crews of the principal.

It is respectfully requested that an initial reserve of $40,600 be established at this time to cover anticipated losses as follows: Performance, $47,000; Payment, $17,600; Investigation costs, attorneys fees, claim adjustment expenses and consultant costs, $5,000; Less remaining contract funds of $29,000.

## INDEMNITY

An initial investigation into the alleged real estate holdings of the indemnitors has resulted in reports by two companies that, in fact, there is no property currently owned by the indemnitors or the principal in Southern California. The Surety is proceeding to have a comprehensive asset check performed in California and also in Nevada, to ascertain if there are any assets held by either the corporate principal or the individual indemnitors. As soon as this information is known to the Surety, you will be advised. As a result of the initial investigation into the alleged real estate holdings of the indemnitor, it would not appear at this time that prospects for indemnity are good.

Your courtesy and cooperation is greatly appreciated.

Sincerely yours,

Joseph R. Cunningham
Claims Attorney

JRC/wsn

cc: American Fidelity Fire Ins. Co.
Attorney in Fact
SBA Regional Office

U.S. SMALL BUSINESS ADMINISTRATION

APP[redacted]N FOR SURETY BOND GUARANT[redacted]ANCE

7

TO BE COMPLETED BY PRINCIPAL

TRADE NAME OF PRINCIPAL Mountain Enterprises Inc. dba Wyatt's Painting and Drywall

PRINCIPAL'S HOME ADDRESS, STREET, CITY AND STATE (Include ZIP)
Route 3, Box 91
Gardnerville, Nevada 89410

PRINCIPAL'S BUSINESS ADDRESS, STREET, CITY AND STATE (Include COUNTY AND ZIP)
Same as above

PRINCIPAL'S EMPLOYER ID NUMBER
88-0144634

TO BE COMPLETED BY BROKER/AGENT (Producer)

NAME OF SURETY
American Fidelity Fire Insurance Co

NAME OF BROKER/AGENT (Producer)
Clark-Leavitt Agency

BROKER/AGENT (Producer's) STREET, CITY AND STATE (Include COUNTY AND ZIP)
P. O. Box 15350
Las Vegas, Clark, Nevada 89114

BROKER/AGENT (Producer's) TELEPHONE NUMBER (Include Area Code)
702-385-7195

BROKER/AGENT (Producer's) EMPLOYER ID NUMBER
88-0149065

1. Applicant hereby states and affirms the following: new venture as of 10/1/77; volume as of 7/31 was $160,835.00

a. The annual gross receipts of my business (including affiliates, as set forth in Part 121 of SBA's Rules and Regulations) during past fiscal year was $ see above or, as annually averaged over the past 3 fiscal years, was $ ________ . (to the near hundreds). If there are affiliates, attach an explanation sheet, delineating annual gross receipts of each as their interests appear. If there stockholders, attach an explanation sheet specifying what their shares of the organization(s) are.

Type of business: ☐ Proprietorship, ☐ Partnership, ☒ Corporation.
Year Business Formed: 1977 Joint Venture ☐ Yes ☒ No

b. A bid, payment or performance bond is required on the following project in order for me to serve as a ☒ primary contractor or ☐ subcontractor thereon.

c. Contractor certifies having attempted (and failed) to obtain the required bonds without the SBA's guarantee; furthermore, the contractor certifies being aware that some sureties charge higher premium rates for bonds than others do, in accordance with premium rate schedules filed in various States.

d. (1) Brief description of this contract work: exterior painting, base hospital
(2) Estimated time required for completion: 1 year (months) Contract have Penalty Clause? ☒ Yes ☐ No. If "yes", how much? $25.00 per calendar or wkg. day.
(3) Anticipated project start date: mo. 10 day ___ yr. 78 (4) Projected completion date: mo. 10 day ___ yr. 79
(5) Project Location: Travis A.F.B. (6) Name of ☒ obligee or ☐ Prime Contractor: U.S.A. - Dept. of Air Force

e. Approximate value of contract: $ 100,000.00 .

f. Applicant, in consideration of assistance from the SBA, herewith agrees it will comply with the nondiscrimination requirements of Title 13, Code of Federal Regulations, Part 112 and Part 113.

g. SBA is authorized to request this information under Executive Order 11625. It will be used only for statistical purposes. You are not required to disclose this information. Failure to do so will not affect your application.
(1) Principal is a ☒ Veteran ☐ Vietnam-ERA Veteran or ☐ Non Veteran (Check one)
(2) Principal is a ☒ Male ☐ Female
(3) Principal is a (0) ☐ Black, (1) ☐ Puerto Rican, (2) ☐ American Indian, (3) ☐ Hispanic (Includes Mexican-American, Cuban, Central or South American or others of Spanish Descent, (4) ☐ Asian (Includes persons of Chinese, Japanese, Korea and Filipino Descent. Also, native Hawaiians, Indonesians, Samoans, Polynesians and Micronesians, (5) ☐ Eskimos and Aleuts, (6) ☐ Undetermined, (7) ☒ Others-including Caucasians.

2. The date, time and place of the bid opening is as follows: (if applicable):
Date 9-13-78 | Time | Place Travis A.F.B.

3. I have read the "Contractor's Processing Fee" section (reverse side) and agree to abide by this fee schedule, PROVIDED I receive contract sought and SBA extends its bond guarantee. I also agree to pay the contractor's SBA's processing fee to my Agent/Broker in accordance with Paragraph 9 reverse side.

4. I ☒ do not have an SBA Loan. I ☐ had a previous SBA Loan. I ☐ do have an SBA Loan through the SBA Office in ________ with a balance of $ ________ as of (Date) ________ Loan No. ________

5. I ☐ am ☒ am not an SBA 8(a) Qualified Contractor (Approved business plan on file)
This bond application ☐ does ☒ does not pertain to an 8(a) contract

6. I do ☐ or do not ☒ request Management Assistance.
I have ☐ or have not ☒ previously received SBA Management Assistance.

7. ☒ have ☐ have not received previous SBA bond guarantee, either under this trade name or another
If under another trade name, specify:
Trade Name: ________
City/State: ________
When? 19 ___ to 19 ___

8. Have you ever defaulted on any previous surety bonds (SBA or other) (either under this contracting concern's trade name or any other concern's of which you have been a principal)? ☐ Yes ☒ No
If "yes", detailed particulars are to be attached to all four (4) copies of this application form. Particulars should include at least the following: (1) Name of Surety; (2) Name of obligee; (3) SBG No. with suffix Number, if applicable (4) Value of Contracts; (5) Date of Default; (6) Status of Default/Claim, i.e., amount of loss to Surety, etc; (7) Contractor's narrative explanation as to reason for default and actions taken to meet the obligations to the Surety under term of the bond(s).

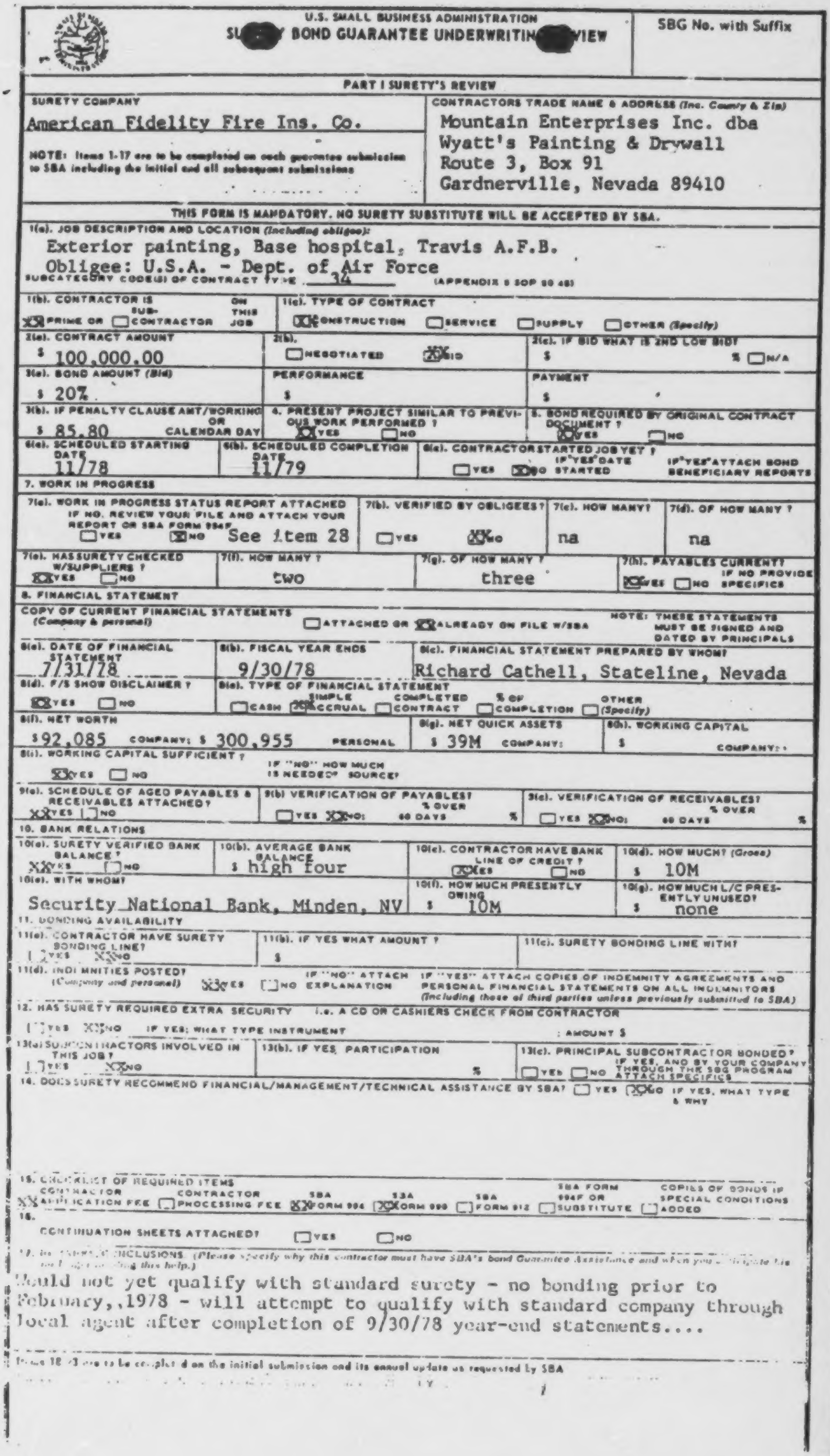
9. Applicant hereby authorizes any agent, broker, surety company or financial institution in possession of credit, financial or work experience information concerning the undersigned applicant and the applicant's business to release the same to SBA, in order that SBA may evaluate the same for the purpose of bond guarantee assistance. Applicant certifies that any information he submits to any agent, broker or surety company for their evaluation as to the bondability of this contractor is correct and accurate to the best of the contractor's knowledge.

10. Any intentionally false statement in this application or willful misrepresentation relative thereto is a violation of federal law, which may subject you to criminal and civil prosecution, 18 U.S.C. Sections 287, 371, 1001; 15 U.S.C. Section 645; 31 U.S.C. Section 231, carrying fines up to $10,000 and imprisonment up to five years.

11. Certification: I hereby certify that all information presented herein is complete and accurate to the best of my knowledge I further agree to notify SBA, in writing, of any fee(s) paid by me or my designee(s) to the Surety and/or it's representatives which are in excess of the fee structure noted in Paragraph 3, above, and specified in Paragraph 9, reverse side. (Attach a separate sheet, detailing amount of such excessive fee(s) and purpose thereof).

Signature (Applicant) X Date 9 / 6 / 78
Title: President

TO BE COMPLETED BY SBA
DATE REC'D. BY SBA / /
BY: (NAME)
SBG NO.



U.S. SMALL BUSINESS ADMINISTRATION
SU[redacted] BOND GUARANTEE UNDERWRITIN[redacted]VIEW

SBG No. with Suffix

PART I SURETY'S REVIEW

SURETY COMPANY
American Fidelity Fire Ins. Co.

NOTE: Items 1-17 are to be completed on each guarantee submission to SBA including the initial and all subsequent submissions

CONTRACTORS TRADE NAME & ADDRESS (Inc. County & Zip)
Mountain Enterprises Inc. dba
Wyatt's Painting & Drywall
Route 3, Box 91
Gardnerville, Nevada 89410

THIS FORM IS MANDATORY. NO SURETY SUBSTITUTE WILL BE ACCEPTED BY SBA.

1(a). JOB DESCRIPTION AND LOCATION (Including obligee):
Exterior painting, Base hospital, Travis A.F.B.
Obligee: U.S.A. - Dept. of Air Force
SUBCATEGORY CODE(S) OF CONTRACT TYPE 34 (APPENDIX 8 SOP 50 45)

1(b). CONTRACTOR IS ☒ PRIME OR ☐ SUB-CONTRACTOR ON THIS JOB
1(c). TYPE OF CONTRACT ☒ CONSTRUCTION ☐ SERVICE ☐ SUPPLY ☐ OTHER (Specify)

2(a). CONTRACT AMOUNT $ 100,000.00
2(b). ☐ NEGOTIATED ☒ BID
2(c). IF BID WHAT IS 2ND LOW BID? $ % ☐ N/A

3(a). BOND AMOUNT (Bid) $ 20%
PERFORMANCE $
PAYMENT $

3(b). IF PENALTY CLAUSE AMT/WORKING OR CALENDAR DAY $ 85.80
4. PRESENT PROJECT SIMILAR TO PREVIOUS WORK PERFORMED? ☒ YES ☐ NO
5. BOND REQUIRED BY ORIGINAL CONTRACT DOCUMENT? ☒ YES ☐ NO

6(a). SCHEDULED STARTING DATE 11/78
6(b). SCHEDULED COMPLETION DATE 11/79
6(c). CONTRACTOR STARTED JOB YET? ☐ YES ☒ NO IF "YES" DATE STARTED IF "YES" ATTACH BOND BENEFICIARY REPORTS

7. WORK IN PROGRESS
7(a). WORK IN PROGRESS STATUS REPORT ATTACHED IF NO, REVIEW YOUR FILE AND ATTACH YOUR REPORT OR SBA FORM 994F ☐ YES ☒ NO See item 28
7(b). VERIFIED BY OBLIGEES? ☐ YES ☒ NO
7(c). HOW MANY? na
7(d). OF HOW MANY? na
7(e). HAS SURETY CHECKED W/SUPPLIERS? ☒ YES ☐ NO
7(f). HOW MANY? two
7(g). OF HOW MANY? three
7(h). PAYABLES CURRENT? ☒ YES ☐ NO IF NO PROVIDE SPECIFICS

8. FINANCIAL STATEMENT
COPY OF CURRENT FINANCIAL STATEMENTS (Company & personal) ☐ ATTACHED OR ☒ ALREADY ON FILE W/SBA
NOTE: THESE STATEMENTS MUST BE SIGNED AND DATED BY PRINCIPALS
8(a). DATE OF FINANCIAL STATEMENT 7/31/78
8(b). FISCAL YEAR ENDS 9/30/78
8(c). FINANCIAL STATEMENT PREPARED BY WHOM? Richard Cathell, Stateline, Nevada
8(d). F/S SHOW DISCLAIMER? ☒ YES ☐ NO
8(e). TYPE OF FINANCIAL STATEMENT ☐ CASH ☒ SIMPLE ACCRUAL ☐ COMPLETED CONTRACT ☐ % OF COMPLETION ☐ OTHER (Specify)
8(f). NET WORTH $92,085 COMPANY; $ 300,955 PERSONAL
8(g). NET QUICK ASSETS $ 39M COMPANY;
8(h). WORKING CAPITAL $ COMPANY;
8(i). WORKING CAPITAL SUFFICIENT? ☒ YES ☐ NO IF "NO" HOW MUCH IS NEEDED? SOURCE?

9(a). SCHEDULE OF AGED PAYABLES & RECEIVABLES ATTACHED? ☒ YES ☐ NO
9(b) VERIFICATION OF PAYABLES? ☐ YES ☒ NO; % OVER 60 DAYS %
9(c). VERIFICATION OF RECEIVABLES? ☐ YES ☒ NO; % OVER 60 DAYS %

10. BANK RELATIONS
10(a). SURETY VERIFIED BANK BALANCE? ☒ YES ☐ NO
10(b). AVERAGE BANK BALANCE $ high four
10(c). CONTRACTOR HAVE BANK LINE OF CREDIT? ☒ YES ☐ NO
10(d). HOW MUCH? (Gross) $ 10M
10(e). WITH WHOM? Security National Bank, Minden, NV
10(f). HOW MUCH PRESENTLY OWING $ 10M
10(g). HOW MUCH L/C PRESENTLY UNUSED? $ none

11. BONDING AVAILABILITY
11(a). CONTRACTOR HAVE SURETY BONDING LINE? ☐ YES ☒ NO
11(b). IF YES WHAT AMOUNT? $
11(c). SURETY BONDING LINE WITH?
11(d). INDEMNITIES POSTED? (Company and personal) ☒ YES ☐ NO IF "NO" ATTACH EXPLANATION IF "YES" ATTACH COPIES OF INDEMNITY AGREEMENTS AND PERSONAL FINANCIAL STATEMENTS ON ALL INDEMNITORS (Including those of third parties unless previously submitted to SBA)

12. HAS SURETY REQUIRED EXTRA SECURITY i.e. A CD OR CASHIERS CHECK FROM CONTRACTOR
☐ YES ☒ NO IF YES; WHAT TYPE INSTRUMENT ; AMOUNT $

13(a) SUBCONTRACTORS INVOLVED IN THIS JOB? ☐ YES ☒ NO
13(b). IF YES, PARTICIPATION %
13(c). PRINCIPAL SUBCONTRACTOR BONDED? ☐ YES ☐ NO IF YES, AND BY YOUR COMPANY THROUGH THE SBG PROGRAM ATTACH SPECIFICS

14. DOES SURETY RECOMMEND FINANCIAL/MANAGEMENT/TECHNICAL ASSISTANCE BY SBA? ☐ YES ☒ NO IF YES, WHAT TYPE & WHY

15. CHECKLIST OF REQUIRED ITEMS
☒ CONTRACTOR APPLICATION FEE ☐ CONTRACTOR PROCESSING FEE ☒ SBA FORM 994 ☒ SBA FORM 990 ☐ SBA FORM 912 ☐ SBA FORM 994F OR SUBSTITUTE ☐ COPIES OF BONDS IF SPECIAL CONDITIONS ADDED

16. CONTINUATION SHEETS ATTACHED? ☐ YES ☐ NO

17. IN [illegible] CONCLUSIONS (Please specify why this contractor must have SBA's bond Guarantee Assistance and when you anticipate his no longer needing this help.)

Would not yet qualify with standard surety - no bonding prior to February,,1978 - will attempt to qualify with standard company through local agent after completion of 9/30/78 year-end statements....

Items 18-23 are to be completed on the initial submission and its annual update as requested by SBA

21(a). CONTRACTOR EVER FAILED T[redacted]ETE JOB? ☐ YES ☐ NO IF "YES" ATTACH S[redacted]ICS

21(b). HAS CONTRA[redacted]ER DEFAULTED ON A CONTRACT FORCING A [redacted] O SUFFER A LOSS? ☐ YES ☐ NO [redacted] ATTACH SPECIFICS

22(a). CONTRACTOR HAVE ADEQUATE EQUIPMENT? ☐ YES ☐ NO

22(b). OWNED? ☐ YES ☐ NO

22(c). LEASED? ☐ YES ☐ NO

23. CONTRACTOR TAXES CURRENT? ☐ YES ☐ NO IF "NO" ATTACH SPECIFICS

24. CONTRACTOR INSURANCE COVERAGE SUFFICIENT? ☐ YES ☐ NO

25(a). CONTRACTOR PREVIOUSLY BONDED? ☐ YES ☐ NO

25(b). LARGEST AMOUNT BONDED? $ JOB: $ WORK PROGRAM

25(c). WITH WHOM?

25(d). IF CHANGE OF SURETY, WHY?

26. ATTACHED RESUME(S) OF OFFICERS, OWNERS AND/OR KEY EMPLOYEES ☐ YES ☐ NO

27(a). MANAGING AGENCY OF SURETY *(If applicable)*
The Leavitt Group

27(b). MANAGING AGENCY'S EMPLOYER (IRS) I.D.
88-0085613

28. REMARKS/CONCLUSIONS
Re work in progress: $143,750 job at Travis AFB (see SBG 0900-00082-004-51), 10%; $116,998 bond on 0900-00782-005-53 being issued today.

IN OUR OPINION THE PRINCIPAL APPEARS TO HAVE THE FINANCIAL/MANAGEMENT/TECHNICAL ABILITIES TO SUCCESSFULLY COMPLETE THIS CONTRACT, HOWEVER, WE FEEL THIS CONTRACTOR FALLS BELOW THE NORMAL UNDERWRITING STANDARD OF OUR COMPANY, AND WE WILL NOT ISSUE BONDS TO THIS CONTRACTOR WITHOUT THE SBA GUARANTEE.

SIGNATURE OF UNDERWRITER: Doris Clark

DATE: 9-6-78

TYPED NAME: Doris Clark

TELEPHONE NO. *(Inc. Area Code)*: 702-385-7195

TITLE OF UNDERWRITER: Attorney-in-Fact

AGENCY NAME *(if applicable)*: Clark-Leavitt Agency

ADDRESS OF UNDERWRITER: P. O. Box 15350

CITY: Las Vegas

STATE: Nevada

ZIP: 89114

DATE RECEIVED BY SBA: SEP 8 1978

BY: *(Initials)*

PART II SURETY'S REVIEW TO BE COMPLETED BY SBA

1. MEETS SBG SIZE STANDARDS ☑ YES ☐ NO

2. FINANCIAL/MANAGEMENT/TECHNICAL ASSISTANCE REQUESTED OR RECOMMENDED ☐ YES ☑ NO

2(a). BY WHOM?

2(b). WHAT TYPE?

2(c). SBA ACTION TAKEN

3(a). IF NECESSARY ASSISTANCE IS NOT READILY AVAILABLE IN GOVERNMENT HAVE YOU REFERRED APPLICANT TO FUNDED ASSISTANCE PROGRAMS, i.e. MINORITY CONTRACTORS ASSISTANCE PROJECT *(MCAP)*, ETC.? ☐ YES ☐ NO

3(b). IF YES NAME THE PROGRAM(S):

4. BASED ON THE UNDERWRITING DATA SUBMITTED:

4(a). THERE ☑ IS ☐ IS NOT REASON TO EXPECT SUCCESSFUL COMPLETION OF THE CONTRACT

4(b). THE COSTS ☐ DO NOT ☑ DO APPEAR TO BE REASONABLE IN ACCORDANCE WITH STD. SURETY INDUSTRY PRACTICES

5. IT HAS BEEN DETERMINED THAT THE REQUESTED BOND(S) ☑ IS ☐ IS NOT NECESSARY, REQUIRED BY THE CONTRACT DOCUMENT'S TERMS, AND THE SURETY HAS INDICATED THAT IT WILL NOT ISSUE THE BOND(S) WITHOUT THE SBA GUARANTEE. FURTHERMORE, NO ADVERSE DATA CONCERNING THE SURETY'S PREMIUM/FEE SCHEDULE WAS REVEALED IN THE CONTRACTOR'S APPLICATION *(SBA Form 994)*

6. ATTACHMENTS *(Check appropriate boxes)*

| | | | | | |
|---|---|---|---|---|---|
| ☐ | CONTINUATION SHEETS | ☐ | INDEMNITY AGREEMENT(S) | ☑ | SBA FORM 994 |
| ☑ | CONTRACTOR'S CURRENT BUSINESS FINANCIAL STATEMENT | ☑ | PERSONAL FINANCIAL STATEMENT(S) | ☑ | SBA FORM 912 |
| ☐ | RESUMES OF PRINCIPAL(S) OWNER(S) AND OR KEY EMPLOYEES | ☑ | SBA FORM 990 | ☐ | SBA FORM 994F |

7. REMARKS/CONCLUSIONS
[illegible]: Bonded contracts (-004 + -005) = $247,[illegible].
This job also has a one year term.

8. PRINCIPAL'S TRADE NAME [illegible] Painting -007

9. RECOMMENDATION/ACTION

| APPROVE | DISAPPROVE | SIGNATURE | TITLE | DATE |
|---|---|---|---|---|
| ☑ | ☐ | | SBS | 9/11/78 |
| ☑ | ☐ | | Chief, CED Division | 9/11/78 |

## U.S. SMALL BUSINESS ADMINISTRATION
## SURETY BOND GUARANTEE AGREEMENT

**PART I**

The Small Business Administration, an Agency of the United States Government, hereinafter called SBA, pursuant to the authority contained in Part B of Title IV of the Small Business Investment Act, as amended, 15 USC Sections 694a and b, and to the regulations issued pursuant thereto, and in consideration of Surety's payment of the SBA's guarantee fee and issuance of the bond(s) requested by the Principal, and in reliance upon the declarations contained in Part I and subject to the terms and conditions contained in Part II, agrees to guarantee the Surety against up to 90 percent of the loss it suffers as the result of the Principal's breach of the terms of the contract bonded.

| | |
|---|---|
| Surety Name<br>American Fidelity Fire Insurance Co. | Principal's Trade Name<br>Mountain Enterprises Inc.<br>dba Wyatt's Painting & Drywall |
| Surety Underwriter's Name<br>Doris Clark | Principal's Trade Address:<br>Street Route 3, Box 91 |
| Principal's Name<br>W. C. Wyatt | City, State, Zip and County<br>Gardnerville, Nevada 89410 |

A. DESCRIPTION OF NATURE, LOCATION, AMOUNT AND EXTENT OF WORK TO BE DONE ON:

(a) Contract
Exterior painting, Base hospital, Travis A.F.B.

(b) Obligee
U.S.A. - Department of Air Force

IF SUBCONTRACT ON PUBLICLY-FINANCED PROJECT, SPECIFY BOTH PRIME CONTRACTOR AND PUBLIC SECTOR OBLIGE

B. WHERE APPLICABLE THIS AGREEMENT CONFIRMS THE ORAL COMMITMENT MADE BY

| | | |
|---|---|---|
| Name of SBA Official | Of the SBA Office in (City and State) | |
| To: (Name of authorized representative for surety) | Of: (City & State) | On (Date) |

This confirmation is being submitted within 15 calendar days of oral commitment, as required by SBA regulations.

This Agreement shall take effect upon signing by the authorized SBA representative, and all terms and conditions inserted herein must be initialed by both SBA and Surety.

| | | |
|---|---|---|
| Signature of Surety's Authorized Representative:<br>Typed Name | Title | Date |
| SBA Signature<br>Typed Name ☒ Returned with special conditions (below)<br>Disposition: ☐ Approved ☐ Disapproved ☐ Returned/Withdrawn | Title<br>Chief [illegible] | Date<br>[illegible] |

In witness thereof, the Small Business Administration has caused this guarantee to be executed this [illegible] day of [illegible] in accordance with published SBA regulations, SBA Guarantee Equals %.

Special Conditions By SBA Only ☐ Yes ☐ No (If "Yes", Specify)

| | | | |
|---|---|---|---|
| Surety Signature (For Special Conditions)<br>☐ Approve ☐ Decline | Date | SBA Signature (for Special condition(s), if approved by Surety) | Date |

PLEASE COMPLETE WHEN DATA IS AVAILABLE

[illegible] for ALL Submissions

| | | |
|---|---|---|
| 1. [illegible] | 2. Estimated Contract Amounts | 3. Contract:<br>☐ Bid ☐ Negotiated |
| 4. [illegible]<br>☐ Bid ☐ Payment ☐ Performance | 5. Bond Amount (%)<br>Bid Payment Performance | 6. Contract Awarded (If "yes", complete 7-14)<br>☐ Yes ☐ No |

[illegible] Only for Contracts Awarded.

| | | |
|---|---|---|
| 7. [illegible] | 8. Amount of Contract | 9. SBA Processing Fee [illegible]<br>$ |
| 10. [illegible]<br>$ Payment $ [illegible] Performance $ [illegible] | 11. Premium Charged<br>$ | % [illegible] |
| [illegible]<br>Payment # Performance # | 12. [illegible] District | [illegible] |

14. If [illegible] job was Bid, BID SPREAD:

[illegible] SBA

[illegible]

8 all file

*United Inspection Bureau, Inc.*
*Surety Bond Claims*

*15910 Ventura Boulevard, Encino, California, 91436*
*telephone (213) 788-9420*

July 9, 1979

Mr. Sal Lauricella
Chief Underwriter
Surety Bond Guarantee
Underwriting Division
Small Business Administration
1441 L, N.W.
Washington, D.C. 20416

Re: Mountain Enterprises, dba: Wyatt Painting & Dry Wall
Bond No: 04-714-1277773
SBG No: 0900-00782-007-57
Obligee: Department of the Air Force, Travis Air Force Base
Project: Travis Air Force Base Hospital

DEFAULT NOTIFICATION - INITIAL STATUS REPORT

Dear Mr. Lauricella:

The following is pursuant to required notification procedures.

Surety issued a Performance Bond in the amount of $87,885 and a Payment Bond in the amount of $43,942.50 on the above referenced project.

The principal defaulted on this project by disappearing and Surety became aware of problems when contacted by the job superintendent, stating that the principal had told him he was in the process of filing bankruptcy. As to date, the Surety has found no indication that, in fact, the principal has filed bankruptcy, however, all efforts to contact the principal have been in vain.

Upon receipt of notification of possible problems on this project, as well as the others, which are the subject of separate prior status reports to your office, Surety commenced an investigation

*Authorized Representative of American Fidelity Fire Insurance Company, Woodbury, New York*

and ascertained that this project had been completed, however, there was a sub-contractor claim against the project in the amount of $19,500, and that there was a material claim against the project in the amount of $3,366.47.

The project has been completed and accepted and it is not anticipated that there will be any performance claims on this project. There are no remaining contract funds available to the Surety to offset any losses.

It is respectfully requested that the SBA establish an initial reserve of $25,000 to cover the above referenced Payment Bond Claimants, attorneys fees, claims adjustment expenses and consultant fees.

## INDEMNITY

As previously reported on the other files open on this principal, an initial check of the alleged real estate holdings indicated on the financial statement submitted at the time the bonds were issued, has resulted in negative findings. The Surety is currently undertaking a comprehensive Asset Check and when the results of said Asset Check are known, you will be further updated in this regard.

Your courtesy and cooperation is greatly appreciated.

Sincerely yours,

Joseph R. Cunningham

Joseph R. Cunningham
Claims Attorney

JRC/wsn

cc: American Fidelity Fire Ins. Co.
    Attorney in Fact
    SBA Regional Office

9

U.S. SMALL BUSINESS ADMINISTRATION
APPLICA[illegible] FOR SURETY BOND GUARANTEE A[illegible]ICE

| | |
|---|---|
| **TO BE COMPLETED BY PRINCIPAL** | **TO BE COMPLETED BY BROKER/AGENT (Producer)** |
| TRADE NAME OF PRINCIPAL MOUNTAIN ENTERPRISES, INC., DBA WYATT'S PAINTING AND DRYWALL | NAME OF SURETY<br>AMERICAN FIDELITY FIRE INSURANCE COMPANY |
| PRINCIPAL'S HOME ADDRESS, STREET, CITY AND STATE (Include ZIP)<br>584 Maywood Way<br>Fairfield, California 94533 | NAME OF BROKER/AGENT (Producer)<br>CLARK-LEAVITT AGENCY |
| PRINCIPAL'S BUSINESS ADDRESS, STREET, CITY AND STATE (Include COUNTY AND ZIP)<br>Same as above | BROKER/AGENT (Producer's) STREET, CITY AND STATE (Include COUNTY AND ZIP) P. O. Box 15350,<br>Las Vegas, Clark, Nevada 89114 |
| | BROKER/AGENT (Producer's) TELEPHONE NUMBER (Include Area Code)<br>702 -- 385-7195 |
| PRINCIPAL'S EMPLOYER ID NUMBER<br>88-0144634 | BROKER/AGENT (Producer's) EMPLOYER ID NUMBER<br>88-0149065 |

1. Applicant hereby states and affirms the following:

a. The annual gross receipts of my business (including affiliates, as set forth in Part 121 of SBA's Rules and Regulations) during the past fiscal year was $ 173,366.00 or, as annually averaged over the past 3 fiscal years, was $ ______. (to the nearest hundreds). If there are affiliates, attach an explanation sheet, delineating annual gross receipts of each as their interests appear. If there are stockholders, attach an explanation sheet specifying what their shares of the organization(s) are.

Type of business: ☐ Proprietorship, ☐ Partnership, ☒ Corporation.
Year Business Formed: 1977 Joint Venture ☐ Yes ☒ No

b. A bid, payment or performance bond is required on the following project in order for me to serve as a ☒ primary contractor or ☐ subcontractor thereon.

c. Contractor certifies having attempted (and failed) to obtain the required bonds without the SBA's guarantee; furthermore, the contractor certifies being aware that some sureties charge higher premium rates for bonds than others, do, in accordance with premium rate schedules filed in various States.

d. (1) Brief description of this contract work: Exterpor Painting, Industrial Buildings
(2) Estimated time required for completion: six: (months) Contract have Penalty Clause? ☒ Yes ☐ No.
If "yes", how much? $ ______ per calendar or wkg. day. 1¢ per squage foot
(3) Anticipated project start date: mo. 3 day ___ yr. 79 (4) Projected completion date: mo. 9 day ___ yr. 79
(5) Project Location: Mare Island, Vallejo, Calif. Name of ☒ obligee or ☐ Prime Contractor: USA, DEPARTMENT OF THE NAVY

e. Approximate value of contract: $ 55,000.00

f. Applicant, in consideration of assistance from the SBA, herewith agrees it will comply with the nondiscrimination requirements of Title 13, Code of Federal Regulations, Part 112 and Part 113.

g. SBA is authorized to request this information under Executive Order 11625. It will be used only for statistical purposes. You are not required to disclose this information. Failure to do so will not affect your application.
(1) Principal is a ☒ Veteran ☐ Vietnam-ERA Veteran or ☐ Non Veteran (Check one)
(2) Principal is a ☒ Male ☐ Female
(3) Principal is a (0) ☐ Black, (1) ☐ Puerto Rican, (2) ☐ American Indian, (3) ☐ Hispanic (Includes Mexican-American, Cuban, Central or South American or others of Spanish Descent, (4) ☐ Asian (Includes persons of Chinese, Japanese, Korean, and Filipine Descent. Also, native Hawaiians, Indonesians, Samoans, Polynesians and Micronesians, (5) ☐ Eskimos and Aleuts, (6) ☐ Undetermined, (7) ☒ Others-including Caucasians.

2. The date, time and place of the bid opening is as follows: (if applicable):
Date 2/27/79 Time 4:00 P.M. Place Mare Island, Vallejo, California

3. I have read the "Contractor's Processing Fee" section (reverse side) and agree to abide by this fee schedule, PROVIDED I receive the contract sought and SBA extends its bond guarantee. I also agree to pay the contractor's SBA's processing fee to my Agent/Broker in accordance with Paragraph 9 reverse side.

4. I ☒ do not have an SBA Loan. I ☐ had a previous SBA Loan. I ☐ do have an SBA Loan through the SBA Office in ______ with a balance of $ ______ as of (Date) ______ Loan No. ______

5. I ☐ am ☒ am not an SBA 8(a) Qualified Contractor (Approved business plan on file)
This bond application ☐ does ☒ does not pertain to an 8(a) contract

5. I do ☐ or do not ☒ request Management Assistance.
I have ☐ or have not ☒ previously received SBA Management Assistance.

7. I ☒ have ☐ have not received previous SBA bond guarantee, either under this trade name or another
If under another trade name, specify:
Trade Name: ______
City/State: ______
When? 19 __ to 19 __

9. Have you ever defaulted on any previous surety bonds (SBA or other) (either under this contracting concern's trade name or any other concern's of which you have been a principal)? ☐ Yes ☒ No
If "yes", detailed particulars are to be attached to all four (4) copies of this application form. Particulars should include at least the following: (1) Name of Surety; (2) Name of obligee; (3) SBG No. with suffix Number, if applicable (4) Value of Contracts; (5) Date of Default; (6) Status of Default/Claim, i.e., amount of loss to Surety, etc; (7) Contractor's narrative explanation as to reason for default and actions taken to meet the obligations to the Surety under term of the bond(s).

9. Applicant hereby authorizes any agent, broker, surety company or [illegible] information concerning the undersigned [illegible] SBA, [illegible] SBA may evaluate the same for the purpose of [illegible] to any agent, broker or surety company for their [illegible] as to the bondability of this [illegible] is correct and accurate to the best of the contractor's knowledge.

10. Any intentionally false statement in this application or willful misrepresentation relative thereto is a violation of [illegible] may subject you to criminal and civil prosecution, 18 U.S.C. [illegible] 371, 1001; 15 U.S.C. [illegible]; [illegible] Section 231, carrying fines up to $10,000 [illegible] five [illegible].

11. [illegible] I hereby certify that all information [illegible] I further agree to notify SBA, in writing, of any fee(s) paid by me or [illegible] to the Surety and/or it's [illegible] which are in excess of the fee structure noted in Paragraph 3, [illegible] in Paragraph 9, reverse side. (Attach a separate sheet, detailing amount of such excessive fee(s) [illegible].)

Signature (Applicant) ______ Date 2 / 22 / 79

[illegible] Title ______

U.S. SMALL BUSINESS ADMINISTRATION

## SURETY BOND GUARANTEE UNDERWRITING REVIEW

SBG No. with Suffix: 0900-00782

### PART I SURETY'S REVIEW

SURETY COMPANY: AMERICAN FIDELITY FIRE INSURANCE COMPANY

CONTRACTORS TRADE NAME & ADDRESS *(Inc. County & Zip)*:
MOUNTAIN ENTERPRISES, INC., dba
WYATT'S PAINTING AND DRYWALL
584 Maywood Way
Fairfield, California 94533

NOTE: Items 1-17 are to be completed on each guarantee submission to SBA including the initial and all subsequent submissions

THIS FORM IS MANDATORY. NO SURETY SUBSTITUTE WILL BE ACCEPTED BY SBA.

1(a). JOB DESCRIPTION AND LOCATION *(Including obligee)*: Exterior painting of industrial buildings, Mare Island, Vallejo, California - Obligee is U. S. A., Department of the Navy

SUBCATEGORY CODE(S) OF CONTRACT TYPE 34 (APPENDIX 5 SOP 50 45)

1(b). CONTRACTOR IS ☒ PRIME OR ☐ SUB-CONTRACTOR ON THIS JOB

1(c). TYPE OF CONTRACT ☒ CONSTRUCTION ☐ SERVICE ☐ SUPPLY ☐ OTHER *(Specify)*

2(a). CONTRACT AMOUNT $ 55,000.00

2(b). ☐ NEGOTIATED ☒ BID

2(c). IF BID WHAT IS 2ND LOW BID? $ % ☐ N/A

3(a). BOND AMOUNT *(Bid)* $ 20%

PERFORMANCE $

PAYMENT $

3(b). IF PENALTY CLAUSE AMT/WORKING OR CALENDAR DAY $ 1¢ sq. ft.

4. PRESENT PROJECT SIMILAR TO PREVIOUS WORK PERFORMED? ☒ YES ☐ NO

5. BOND REQUIRED BY ORIGINAL CONTRACT DOCUMENT? ☒ YES ☐ NO

6(a). SCHEDULED STARTING DATE: March, 1979

6(b). SCHEDULED COMPLETION DATE: September, 1979

6(c). CONTRACTOR STARTED JOB YET? ☐ YES ☒ NO IF "YES" DATE STARTED IF "YES" ATTACH BOND BENEFICIARY REPORTS

7. WORK IN PROGRESS

7(a). WORK IN PROGRESS STATUS REPORT ATTACHED IF NO, REVIEW YOUR FILE AND ATTACH YOUR REPORT OR SBA FORM 994F ☒ YES ☐ NO

7(b). VERIFIED BY OBLIGEES? ☒ YES ☐ NO

7(c). HOW MANY? two

7(d). OF HOW MANY? three

7(e). HAS SURETY CHECKED W/SUPPLIERS? ☒ YES ☐ NO

7(f). HOW MANY? two

7(g). OF HOW MANY? three

7(h). PAYABLES CURRENT? ☒ YES ☐ NO IF NO PROVIDE SPECIFICS

8. FINANCIAL STATEMENT

COPY OF CURRENT FINANCIAL STATEMENTS *(Company & personal)* ☒ ATTACHED OR ☐ ALREADY ON FILE W/SBA NOTE: THESE STATEMENTS MUST BE SIGNED AND DATED BY PRINCIPALS

8(a). DATE OF FINANCIAL STATEMENT: 9/78 and 2/79

8(b). FISCAL YEAR ENDS: 9/30

8(c). FINANCIAL STATEMENT PREPARED BY WHOM? R. H. Cathel & Associates, Stateline

8(d). F/S SHOW DISCLAIMER? ☒ YES ☐ NO

8(e). TYPE OF FINANCIAL STATEMENT ☐ CASH ☒ SIMPLE ACCRUAL ☐ COMPLETED CONTRACT ☐ % OF COMPLETION ☐ OTHER *(Specify)*

8(f). NET WORTH 221,733 COMPANY: $ 618,200 PERSONAL

8(g). NET QUICK ASSETS $ 70M COMPANY:

8(h). WORKING CAPITAL $ COMPANY:

8(i). WORKING CAPITAL SUFFICIENT? ☒ YES ☐ NO IF "NO" HOW MUCH IS NEEDED? SOURCE?

9(a). SCHEDULE OF AGED PAYABLES & RECEIVABLES ATTACHED? ☐ YES ☒ NO

9(b) VERIFICATION OF PAYABLES? ☐ YES ☒ NO: % OVER 60 DAYS %

9(c). VERIFICATION OF RECEIVABLES? ☐ YES ☒ NO: % OVER 60 DAYS %

10. BANK RELATIONS

10(a). SURETY VERIFIED BANK BALANCE? ☒ YES ☐ NO

10(b). AVERAGE BANK BALANCE $ low five

10(c). CONTRACTOR HAVE BANK LINE OF CREDIT? ☒ YES ☐ NO

10(d). HOW MUCH? *(Gross)* $ 20,000.00

10(e). WITH WHOM? Wells Fargo Bank, Fairfield, California

10(f). HOW MUCH PRESENTLY OWING $ 8,000.00

10(g). HOW MUCH L/C PRESENTLY UNUSED? $ 12,000.00

11. BONDING AVAILABILITY

11(a). CONTRACTOR HAVE SURETY BONDING LINE? ☐ YES ☒ NO

11(b). IF YES WHAT AMOUNT? $

11(c). SURETY BONDING LINE WITH?

11(d). INDEMNITIES POSTED? *(Company and personal)* ☒ YES ☐ NO IF "NO" ATTACH EXPLANATION IF "YES" ATTACH COPIES OF INDEMNITY AGREEMENTS AND PERSONAL FINANCIAL STATEMENTS ON ALL INDEMNITORS *(Including those of third parties unless previously submitted to SBA)*

12. HAS SURETY REQUIRED EXTRA SECURITY i.e. A CD OR CASHIERS CHECK FROM CONTRACTOR ☐ YES ☒ NO IF YES, WHAT TYPE INSTRUMENT , AMOUNT $

13(a). SUBCONTRACTORS INVOLVED IN THIS JOB? ☐ YES ☒ NO

13(b). IF YES PARTICIPATION %

13(c). PRINCIPAL SUBCONTRACTOR [illegible] IF YES, AND BY [illegible] THROUGH THE SBG [illegible] ATTACH SPECIFICS ☐ YES ☐ NO

14. [illegible] SURETY RECOMMEND FINANCIAL/MANAGEMENT/TECHNICAL ASSISTANCE BY SBA? ☐ YES ☒ NO IF YES, WHAT TYPE & WHY

15. [illegible] ☒ APPLICATION FEE ☐ [illegible] GUARANTEE FEE ☒ SBA FORM 994 ☒ SBA FORM 990 ☐ SBA FORM 912 ☐ SBA FORM 994F OR SUBSTITUTE ☐ COPIES OF [illegible] SPECIAL CONDITIONS ADDED

16. CONTINUATION SHEETS ATTACHED? ☐ YES ☒ NO

17. COMMENTS, CONCLUSIONS *(Please specify why this contractor must have SBA's bond Guarantee Assistance and where [illegible] needing this help.)* Has required bonding on projects only since early 1978 - we propose to submit to standard surety when CORRECTED 9/30/78 corporate and personal financial statements are available.

Items 18-23 are to be completed on the initial submission and its annual update as requested by SBA

21(a). CONTRACTOR EVER FAILED TO [illegible]ETE JOB? ☐ YES ☐ NO IF "YES" ATTACH SPECIFICS

21(b). HAS CONTRAC[illegible]ER DEFAULTED ON A CONTRACT FORCING A SU[illegible], TO SUFFER A LOSS? ☐ YES ☐ NO IF "YES" ATTACH SPECIFICS

22(a). CONTRACTOR HAVE ADEQUATE EQUIPMENT? ☐ YES ☐ NO

22(b). OWNED? ☐ YES ☐ NO

22(c). LEASED? ☐ YES ☐ NO

23. CONTRACTOR TAXES CURRENT? IF "NO" ATTACH SPECIFICS ☐ YES ☐ NO

24. CONTRACTOR INSURANCE COVERAGE SUFFICIENT? ☐ YES ☐ NO

25(a). CONTRACTOR PREVIOUSLY BONDED? ☐ YES ☐ NO

25(b). LARGEST AMOUNT BONDED? $ JOB: $ WORK PROGRAM

25(c). WITH WHOM?

25(d). IF CHANGE OF SURETY, WHY?

26. ATTACHED RESUME(S) OF OFFICERS, OWNERS AND/OR KEY EMPLOYEES ☐ YES ☐ NO

27(a). MANAGING AGENCY OF SURETY *(If applicable)*
CLARK-LEAVITT AGENCY

27(b). MANAGING AGENCY'S EMPLOYER *(IRS)* I.D.
88-0149065

28. REMARKS/CONCLUSIONS

IN OUR OPINION THE PRINCIPAL APPEARS TO HAVE THE FINANCIAL/MANAGEMENT/TECHNICAL ABILITIES TO SUCCESSFULLY COMPLETE THIS CONTRACT, HOWEVER, WE FEEL THIS CONTRACTOR FALLS BELOW THE NORMAL UNDERWRITING STANDARD OF OUR COMPANY, AND WE WILL NOT ISSUE BONDS TO THIS CONTRACTOR WITHOUT THE SBA GUARANTEE.

SIGNATURE OF UNDERWRITER: Doris Clark

DATE: February 23, 1979

TYPED NAME: Doris Clark

TELEPHONE NO. *(Inc. Area Code)*: 702 -- 385-7195

TITLE OF UNDERWRITER: Attorney-in-Fact

AGENCY NAME *(If applicable)*: as above

ADDRESS OF UNDERWRITER: P. O. Box 15350

CITY: Las Vegas

STATE: Nevada

ZIP: 89114

DATE RECEIVED BY SBA: FEB 26 1979

BY: *(Initials)*

PART II SURETY'S REVIEW — TO BE COMPLETED BY SBA

1. MEETS SBG SIZE STANDARDS ☑ YES ☐ NO

2. FINANCIAL/MANAGEMENT/TECHNICAL ASSISTANCE REQUESTED OR RECOMMENDED ☐ YES ☑ NO

2(a). BY WHOM?

2(b). WHAT TYPE?

2(c). SBA ACTION TAKEN
Contractor having F/S reworked.

3(a). IF NECESSARY ASSISTANCE IS NOT READILY AVAILABLE IN GOVERNMENT HAVE YOU REFERRED APPLICANT TO FUNDED ASSISTANCE PROGRAMS, i.e. MINORITY CONTRACTORS ASSISTANCE PROJECT *(MCAP)*, ETC.? ☐ YES ☑ NO

3(b). IF YES NAME THE PROGRAM(S):

4. BASED ON THE UNDERWRITING DATA SUBMITTED:

4(a). THERE ☑ IS ☐ IS NOT REASON TO EXPECT SUCCESSFUL COMPLETION OF THE CONTRACT

4(b). THE COSTS ☐ DO NOT ☑ DO APPEAR TO BE REASONABLE IN ACCORDANCE WITH STD. SURETY INDUSTRY PRACTICES

5. IT HAS BEEN DETERMINED THAT THE REQUESTED BOND(S) ☑ IS ☐ IS NOT NECESSARY, REQUIRED BY THE CONTRACT DOCUMENT'S TERMS, AND THE SURETY HAS INDICATED THAT IT WILL NOT ISSUE THE BOND(S) WITHOUT THE SBA GUARANTEE. FURTHERMORE, NO ADVERSE DATA CONCERNING THE SURETY'S PREMIUM/FEE SCHEDULE WAS REVEALED IN THE CONTRACTOR'S APPLICATION *(SBA Form 994)*

6. ATTACHMENTS *(Check appropriate boxes)*

| | | |
|---|---|---|
| ✓ CONTINUATION SHEETS | INDEMNITY AGREEMENT(S) | ✓ SBA FORM 994 |
| ✓ CONTRACTOR'S CURRENT BUSINESS FINANCIAL STATEMENT | ✓ PERSONAL FINANCIAL STATEMENT(S) | SBA FORM 912 |
| RESUME OF PRINCIPAL(S) [illegible] AND OR KEY [illegible] | ✓ SBA FORM 990 | ✓ SBA FORM 994F |

7. [illegible]IONS

[illegible] for $325K bid. [illegible] for $55K bid. Operations profitable, [illegible] 7/31/78. Contractor getting [illegible]

8. [illegible]L'S TRADE NAME
[illegible] Painting & Drywall

9. [illegible]ATION/ACTION

| APPROVE | DISAPPROVE | SIGNATURE | TITLE | DATE |
|---|---|---|---|---|
| ☒ | ☐ | [illegible] | [illegible] | [illegible] |
| ✓ | ☐ | [illegible] | [illegible] | [illegible] |

## U.S. SMALL BUSINESS ADMINISTRATION
## SURETY BOND GUARANTEE AGREEMENT

**PART I**

The Small Business Administration, an Agency of the United States Government, hereinafter called SBA, pursuant to the authority contained in Part B of Title IV of the Small Business Investment Act, as amended, 15 USC Sections 694a and b, and to the regulations issued pursuant thereto, and in consideration of Surety's payment of the SBA's guarantee fee and issuance of the bond(s) requested by the Principal, and in reliance upon the declarations contained in Part I and subject to the terms and conditions contained in Part II, agrees to guarantee the Surety against up to 90 percent of the loss it suffers as the result of the Principal's breach of the terms of the contract bonded.

| | |
|---|---|
| Surety Name<br>AMERICAN FIDELITY FIRE INSURANCE COMPANY | Principal's Trade Name<br>[illegible] ENTERPRISES, INC.<br>WYATT'S PAINTING AND DRYWALL |
| Surety Underwriter's Name<br>[illegible] | Principal's Trade Address<br>Street 584 Haywood Way |
| Principal's Name<br>[illegible] | City, State, Zip and County<br>Fairfield, California [illegible] |

**A. DESCRIPTION OF NATURE, LOCATION, AMOUNT AND EXTENT OF WORK TO BE DONE ON:**

(a) Contract
Exterior painting of Industrial Buildings, Mare Island, Vallejo, California

(b) Obligee
[illegible] Department of the Navy

**IF SUBCONTRACT ON PUBLICLY-FINANCED PROJECT, SPECIFY BOTH PRIME CONTRACTOR AND PUBLIC SECTOR OBLIGEE**

**B. WHERE APPLICABLE THIS AGREEMENT CONFIRMS THE ORAL COMMITMENT MADE BY**

| | | |
|---|---|---|
| Name of SBA Official | Of the SBA Office in (City and State) | |
| To: (Name of authorized representative for surety) | Of: (City & State) | On (Date) |

This confirmation is being submitted within 15 calendar days of oral commitment, as required by SBA regulations.

This Agreement shall take effect upon signing by the authorized SBA representative, and all terms and conditions inserted herein must be initialed by both SBA and Surety.

| | | |
|---|---|---|
| Signature of Surety's Authorized Representative:<br>Typed Name | Title | Date |
| SBA Signature<br>Typed Name ☐ Returned with special conditions (below)<br>Disposition: ☐ Approved ☐ Disapproved ☐ Returned/Withdrawn | Title<br>SURETY BOND COORDINATOR | Date |

In witness thereof, the Small Business Administration has caused this guarantee to be executed this ____ day of ______, 19__ in accordance with published SBA regulations, SBA Guarantee Equals ____%.

Special Conditions By SBA Only ☐ Yes ☐ No (If "Yes", Specify)

| | | | |
|---|---|---|---|
| Surety Signature (For Special Conditions)<br>☐ Approve ☐ Decline | Date | SBA Signature (for Special condition(s), if approved by Surety) | Date |

PLEASE COMPLETE WHEN DATA IS AVAILABLE

Items 1-5 to be Completed for ALL Submissions

| | | |
|---|---|---|
| 1. [illegible] (If Bid) | 2. Estimated Contract Amount | 3. [illegible]<br>☐ Bid ☐ [illegible] |
| 4. Bonds Required<br>☐ Bid ☐ Payment ☐ Performance | 5. Bond Amount (%)<br>Bid Payment Performance | 6. Contract Awarded (If "yes", [illegible] 7-14)<br>☒ Yes ☐ No |

Items 7 through 14 [illegible] for Contracts Awarded.

| | | |
|---|---|---|
| 7. [illegible] | 8. Amount of Contract<br>52,880.00 | 9. SBA Processing [illegible]<br>$ 106.00 |
| 10. Bond Amounts<br>Bid $ Payment $26,440.00 Performance $52,880.00 | | 11. Premium Charged<br>$ 793.00 $ [illegible] |
| 12. Bond Numbers<br>Payment #[illegible]351 Performance #Same | | 13. Project for: ☒ Federal ☐ State ☐ Special District ☐ Private |

14. If [illegible], BID SPREAD:

TO BE COMPLETED BY SBA

10

*United Inspection Bureau, Inc.*
*Surety Bond Claims*

*15910 Ventura Boulevard, Encino, California, 91436*
*telephone (213) 788-9420*

June 25, 1979

Mr. Sal Lauricella
Chief Underwriter
Surety Bond Guarantee
Underwriting Division
Small Business Administration
1441 L, N.W.
Washington, D.C. 20416

Re: Mountain Enterprises, Inc., dba: Wyatt's Painting & Dry Wall
Bond No: 04-714-1277851
Claim No: 941279
SBG No: 0900-00782-011-46
Obligee: Department of the Navy

DEFAULT NOTIFICATION - INITIAL STATUS REPORT

Dear Mr. Lauricella:

The following is pursuant to required notification procedures.

The Surety issued a Performance Bond in the amount of $52,880 and a Payment Bond in the amount of $26,440 on the above referenced project.

The Surety was put on notice that the obligee intended to default the above referenced principal and that the principal has disappeared from the job site and had not been seen for approximately 30 days. Numerous attempts by the Surety to contact the principal were fruitless and the principal's whereabouts at this time are unknown.

PERFORMANCE

The contract called for the painting of buildings to be specified by the obligee on a square footage cost basis. Painting had commenced on three buildings, with one building having been completed. The Surety was able to arrange with the obligee to have the contract terminated and remaining portions of the work relet for bid, at no cost to the Surety, with the express condition that the Surety would undertake completion of the two buildings upon which work had commenced, but had not been completed. Surety was able to arrange for the job superintendent and the existing crews working on the project, to complete these two buildings.

## PAYMENT CLAIMS

Apparently the principal had arranged to have the work performed by another contractor, pursuant to an oral sub-contract. This sub-contractor is now making a claim under the Payment Bond in the amount of approximately $14,000. Utilization of this sub-contractor to complete the remaining two buildings, was not possible in view of the fact that the obligee refused to allow said sub-contractor back on the premises, as the sub-contractor in the performance of certain work to date, had allegedly ignored prevailing wind conditions, with a result that approximately 45 cars allegedly were damaged by overspray.

There are known material claims against the project in the amount of approximately $5,000.

## CONTRACT FUNDS

Pursuant to the terms of the contract, which the Surety bonded, there are now due and owing to the Surety for work completed on the theee buildings, contract funds in the amount of $14,282.90. Appropriate requests have been submitted to the obligee and is anticipated that these funds will be received within six to eight weeks.

## RESERVES

It is recommended that an initial reserve of $10,717 be established at this time, to cover anticipated losses as follows: Performance, $3,171; labor and material claims, $19,000; attorneys fees, investigation costs and claim adjustment expenses, $2,829; less contract funds remaining.

## INDEMNITY

Although the initial review of the financial statement submitted by the principal indicated substantial real estate holdings, a subsequent

Title Search conducted by the Surety in those counties where said property was allegedly located, has shown that, in fact, there is no property owned by the principal or the indemnitors in those counties. In view of the fact that the Surety has been unable to make any contact with the principal or the indemnitors and that there are apparently no viable assets to proceed against for salvage recovery, it is anticipated that there is minimum chance of Indemnity Recovery on this file.

As more information becomes availabe and should the status of this matter change, you will be immediately notified.

Your courtesy and cooperationis greatly appreciated.

Sincerely yours,

Joseph R. Cunningham

Joseph R. Cunningham
Claims Attorney

JRC/wsn

cc: American Fidelity Fire Ins. Co.
Attorney in Fact
SBA Regional Office

Call from Barbara Harrison who says that Wyatt has nothing to speak of. Los Angeles: Nothing but a private residence and probably not our Wyatt. (Riverside: Nothing.)

San Diego: Nothing.

Ventura: Nothing.

San Bernardino: Nothing

Mountain Enterprises owns two vacant lots, Lots 66-67, Tract 3005, Lake Forest. Estimate value of $520 each with a return address listed for a John Severen, P. O. Box 102, Lake Arrowhead, California.

Orange County: Lot 168, Tract 8249, Book 362, Pages 17-23 in Miscellaneous Maps. $5,510 assessed value with $1,470 on the improvements.

Imperial County: This is our big hope and Harrison's tentacles could not reach therein. Hence I have called Customer Service of Safeco at (714) 352-2011 to place a call for the information. If this fails, we will call Safeco at Panorama City at 873-7788, Joe Peterson.

Danny from Safeco called and says that Wyatt owns nothing in Imperial County.

**SBA**

U.S. Small Business Administration
Office of Regulatory Audits
Office of Inspector General

# Report on Compliance Audit of

[illegible] INSURANCE COMPANY, Woodbury, New York and
[illegible] S PAINTING AND DRYWALL, Boulder City, Nevada
SURETY BOND [illegible] NUMBERS 0900-00782-004-51, 0900-00782-006-53, [illegible]
0900-00782-008-57, 0900-00782-011-46

Office of Regulatory Audits
Office of the Inspector General

Audit Report No. SBG-81-2

**For Internal Use Only**

## SUMMARY

Findings disclosed by this audit are summarized as follows:

- The principal, Mr. William C. Wyatt, submitted fraudulent financial statements to his agent which the SBA and the surety relied upon to secure Surety Bond Guarantees.
- Neither the surety nor the surety's agent confirmed ownership of the group of assets comprising the majority of Mr. Wyatt's net worth .
- Default notices, status reports and recoveries were not submitted to the SBA in a manner provided for in the Guarantee Agreement.
    - Our examination disclosed that the SBA was not notified of defaults within 30 days as provided by the Guarantee Agreement in three of the four claims examined.
    - In each of the claims examined the SBA did not receive a status report every six months as required by the Terms and Conditions of the Guarantee Agreement.
    - UIB has not adequately disclosed the fraudulent nature of Mr. Wyatt's bond application to the SBA.
    - The surety did not remit recoveries on SBG 0900-00732-005-53 in 90 days as required by the Guarantee Agreement.
- Unallowable administrative costs of $2,549.70 incurred by the surety are not reimbursable by SBA.
- Our examination disclosed a net of five dollars was due the SBA as a result of change orders.

## INTRODUCTION AND BACKGROUND

The Surety, American Fidelity Fire Insurance Company (AFF), executed the following performance and payment bonds for Mountain Enterprises (Mountain) for which the Small Business Administration (SBA) issued Surety Bond Guarantees:

| Bond Number | Effective Date | Contract Amount | Obligee | Status |
|---|---|---|---|---|
| 04-714-1277732 | 7/14/78 | $143,750 | Travis AFB | Default |
| 04-714-1277751 | 7/14/78 | 52,880 | Mare Island | Default |
| 04-714-1277759 | 9/8/78 | 116,998 | Mare Island | Default |
| 04-714-1277773 | 10/5/78 | 87,885 | Travis AFB | Default |

All bonds written by AFF for Mountain Enterprises are in claims status.

### Surety Bond Guarantee (SBG) Number 0900-00782-004-51 - Bond Number 04-714-1277732

SBA issued SBG Number 0900-00782-004-51 on May 31, 1978, authorizing a guarantee for reimbursement of 90 percent of all losses incurred by the surety as a result of executing bond Number 04-714-1277732. The contract was for $143,750 and the term of the performance bond was from July 14, 1978 to July 14, 1979. The contract was to paint exteriors on the Capehart Family Housing Project on Travis Air Force Base, California. The principal walked out of the job on approximately May 14, 1979 after completing approximately 98 percent of this job and it was rumored that he was going to file for bankruptcy. The obligee and surety were notified of this default on May 14, 1979 and completed the work using the principal's supervisor, Mr. Del Sevier.

The following summarizes the cash receipts and disbursements for the claim filed against this bond as of June 20, 1980.

| | |
|---|---|
| Total Surety Payouts (net of nonreimbursable items and deductible) | $48,888.85 |
| Less: Contract Recoveries and overpayments | 15,365.32 |
| Loss: | 33,523.53 |
| Less: Sureties share of Loss (10%) | 3,352.35 |
| SBA's Share of Loss | 30,171.18 |
| SBA's Reimbursement to Surety | 30,036.18 |
| Amount Due Surety from SBA | 135.00 |
| SBA's Net Reimbursement to Surety | $30,171.18 |

### Surety Bond Guarantee Number 0900-00782-011-46 - Bond Number 04-714-1277751

This was a 100 percent performance and 50 percent payment bond for painting industrial buildings at Mare Island, California. The contract was for $52,880 and was guaranteed by the SBA for 90 percent. The term of the bond was from July 14, 1978 to July 14, 1979. When the principal defaulted on the job, the sureties outside attorney, Mr. Michael Bassin, was able to get the obligee to terminate this contract provided the surety completed the three buildings on which the principal had started work. One building was completed while the other two buildings were in various stages of completion.

On May 14, 1979, the obligee was notified of the principal's default on this job. The contract was completed by Mr. Del Sevier, the principal's job superintendent.

The following summarizes the cash receipts and disbursements for the claim filed against this bond as of June 20, 1980:

| | |
|---|---|
| Total Surety Payouts (net of nonreimbursable items and deductible) | $20,543.95 |
| Less: Contract Recoveries | -0- |
| Loss: | 20,543.95 |
| Less: Sureties Share of Loss (10%) | 2054.40 |
| SBA's Share of Loss | 18,489.55 |
| SBA's Reimbursement to Surety | 17,566.08 |
| Amount due Surety from SBA | 923.47 |
| SBA's Net Reimbursement To The Surety | 18,489.55 |

Surety Bond Guarantee Number 0900-00782 005-53 -Bond Number 04-714-1277759

This was a 100 percent performance and 50 percent payment bond for exterior painting of the military family housing units and garages at Mare Island, California. The contract was for $116,998.00 and was guaranteed by the SBA for 90 percent. The term of the bond was from September 8, 1978 to September 8, 1979. At the time of default, the contract was approximately 75 percent complete. This contract was completed by Mr. Del Sevier, the principal's job superintendent.

The following summarizes the cash receipts and disbursements for the claim filed against this bond as of June 20, 1980:

| | |
|---|---|
| Total Surety Payouts (Net of nonreimbursable items and deductible) | $103,688.79 |
| Less: Contract Recoveries | 27,037.55 |
| Loss: | 76,651.24 |
| Less: Sureties Share of Loss (10%) | 7,665.12 |
| SBA's Share of Loss | 68,986.12 |
| SBA's Reimbursement to Surety | 87,999.52 |
| Surety's Reimbursement to SBA | (12,813.98) |
| Amount Due SBA from Surety | (6,199.42) |
| SBA's Net reimbursement to Surety | 68,986.12 |

Surety Bond Guarantee Number 0900-00782-007-57 - Bond Number 04-714-1277773

This was a 100 percent performance and 50 percent payament bond for exterior painting of the base hospital at Travis Air Force Base, California. The contract was for $87,885 and was guaranteed by the SBA for 90 percent. The term of the bond was from October 5, 1978 to October 5, 1979. At the time of default, the project was completed. The only work remaining was to determine the extent of unpaid bills and assess them accordingly.

The following summarizes the cash receipts and disbursements for the claim filed against this bond as of June 20, 1980:

| | |
|---|---|
| Total Surety Payouts (Net of nonreimbursable items and deductible) | $243.81 |
| Less: Contract Recoveries | -0- |
| Loss: | 243.81 |
| Less: Surety's Share of Loss (10%) | 24.38 |
| SBA's Share of Loss | 219.43 |
| SBA's Reimbursement to Surety | -0- |
| Amount Due Surety from SBA | 219.43 |
| SBA's Net Reimbursement to Surety | 219.43 |

Mountain Enterprises Incorporated (Mountain)

Mountain Enterprises Incorporated was owned and operated by William Carter Wyatt. The corporation was formed in September of 1977 and holds a contractor's license to perform painting and drywall work in the state of Nevada. The last known address of Mountain Enterprises is 503 Nevada Highway, Suite No.1, Boulder City, Nevada 89005.

Unaudited corporate financial statements for the five-month period ending February 28, 1979, disclosed sales of $279,677 and net income before taxes of $124,573. The balance sheet disclosed assets of $207,676, liabilities of $47,106, net worth of $160,570, and working capital of $104,769. For February 14, 1979, unaudited personal financial statements for Mr. and Mrs. Wyatt disclosed a net worth of $253,800 at cost and an estimated net worth of $653,800 when valued at fair market value.

Ms. Doris Clark, Underwriter for The Clark-Leavitt Agency, produced this bond. She had previously underwritten bonds for Mr Wyatt while employed by the Lou Jones Agency. She experienced no problems with those bonds.

On approximately May 14, 1979, Mr.Wyatt left the job site and has not been seen since.

## American Fidelity Fire Insurance Company (AFF)

AFF is a subsidiary of the American Plan Corporation (APC) of 100 Crossways Park West, Woodbury, New York 11979. APC was incorporated in 1947 as an insurance company producing, servicing, and underwriting auto, mobile home, physical damage and surety bonds. AFF's chairman of the board is Mr. Murray Lemonick and Mr. Luther H. Williams is the President. AFF's financial statement for December 31, 1979, disclosed the following:

| | |
|---|---:|
| Total Assets | $34,873,814 |
| Net Premiums Earned | 8,103,967 |
| Net Income | 805,344 |

Since the SBG Program's inception, AFF has been an active participant. As of May 31, 1980, SBA has guaranteed approximately 38,400 bonds written by AFF for approximately $2.8 billion. The SBG Program has reimbursed AFF about $54 million for losses incurred in approximately 2,200 surety bond guarantees.

AFF is listed in Treasury Circular 570, 1980 Revision, as a surety company acceptable on Federal bonds with an underwriting limitation of $653,000, and is licensed to transact surety business in all states and U.S. possessions except the Canal Zone, Colorado, Guam, Hawaii, Virgin Islands, Missouri, Nebraska, and New Hampshire.

## Market Insurance Corporation (Market)

Market was incorporated in 1962 as a general insurance agent writing various lines of insurance within the State of California. Market also writes surety bonds in the states in which AFF is licensed, using independent underwriters with whom it has general agent agreements. Under a Managing General Agent Agreement with AFF dated November 10, 1969, Market is responsible for underwriting surety bonds.

Principal officers of Market are Mr. Marvin Uritz, President and 50 percent stockholder, and Mr. Arthur Bernstein, Vice President and 50 percent stockholder. The key person respnsible for the SBG Program is Mr. Terry Beals, Chief Underwriter.

United Inspection Bureau (UIB)

UIB is responsible for handling claims activity arising from breach of contract or default of surety bonds under an oral contract with Market. When made aware of an impending breach or default, the agent who has underwritten a surety bond is required to notify UIB, immediately. UIB is then responsible for notifying SBA of the problem; evaluating its seriousness; and obtaining a local surety attorney to resolve the matter in the most efficient manner.

Principal officers of UIB are Ms. Linda Axel, President, Mr. Marvin Uritz, Vice President, and Mr. Arthur Bernstein, Secretary-Treasurer. The key person coordinating UIB's claims activities is Mr. Perry Lisker, Claims Manager. Linda Axel (Arthur Bernstein's daughter) owns 50 percent of UIB's outstanding stock and 50 percent is owned by a trust established for Mitchel and Shelby Uritz (Marvin Uritz's children).

## SCOPE OF AUDIT

The scope of the audit was limited to a review of the underwriting and claims files maintained by the surety and its attorney. The objective of the audit was to determine that the surety and its managing general agent had complied with the applicable laws, regulations, contract terms and conditions under the SBG program. Our review was performed in accordance with generally accepted auditing standards and included such tests of the surety's records as were determined necessary under the circumstances. The audit was limited to tests of the underwriting and claim files without confirmation of the contractor's records to verify the financial information contained in the underwriting review, SBA Form No. 994B.

Additional areas of question were encountered during the audit and the scope of audit was widened to include a review of the records of the obligee, and the surety's local attorney. The records of the principal were not examined due to his refusal to make his whereabouts known.

## RESULTS OF AUDIT

Based upon our audit, we believe that AFF and the principal have not complied with the applicable laws, regulations, terms and conditions of the Surety Bond Guarantee Agreement in the following areas:

### Fraudulent Underwriting Applications Submitted By The Principal

The principal, Mr. William C. Wyatt, submitted fraudulent financial statements to his agent which the SBA and the surety relied upon to secure Surety Bond Guarantees.

Paragraphs 10 and 11 of the Surety Bond Underwriting Review (SBA Form 994B (8-76)) signed by Mr. Wyatt states:

> "10. Any intentionally false statement in this application or willful misrepresentation relative thereto is a violation of federal law, which may subject you to criminal and civil prosecution, 18 U.S.C. Sections 287, 371, 1001; 15 U.S.C Section 645; 31 U.S.C. Section 231, carrying fines up to $10,000 and imprisonment up to five years.
>
> 11. Certification: I hereby certify that all information presented herein is complete and accurate to the best of my knowledge..."

For the periods ending December 31, 1977, and February 14, 1979 Mr. Wyatt's financial statements represented his net worth at fair market value as $345,995 and $653,800, respectively. The majority ($455,000 of $653,000) of Mr.Wyatt's net worth was attributable to the appreciation in thirteen houses he stated he owned in El Centro, California. When Mr. Wyatt presented his personal financial statement of February 14, 1979, to Ms. Doris Clark, the Surety Bond Underwriter at the Clark-Leavitt Agency, he stated the financial statements presented were incorrect. He stated the appraised value of 13 houses he owned was $565,000 not $465,000 as shown on the statement. In addition, Mr. Wyatt told Ms. Clark the aggregate amount of the mortgages on the 13 houses was $10,000 and, combined, these properties were producing

$1,600 in rental income per month.

Prior to default, neither the surety nor the surety's agent confirmed the existence of the thirteen houses.

Subsequent to the default on the bond, the surety attempted to confirm Mr. Wyatt's property ownership. The surety's attorney hired a private investigator to locate Mr. Wyatt after attempts to contact him by phone and certified mail proved unsuccessful. To date, the attorney has been unable to contact Mr. Wyatt. Independently, the attorney made contact with title companies operating in Southern California to determine if any property was owned in the names of either Mountain Enterprises or Mr. or Mrs. William C. Wyatt. To date, the investigation shows Mountain Enterprises owns two lots in Lake Forest, California valued at $520 each. There are no indications Mr.or Mrs. Wyatt own or owned any real estate in Southern California.

Underwriting

The surety did not confirm ownership of the group of assets comprising the majority of Mr. Wyatt's net worth.

Paragraph 1 of the Terms and Conditions of the Guarantee Agreement (SBA Form 990 (8-76)) addresses the requirements for underwriting. It provides:

> "Surety represents it has determined the accuracy and completeness on the Form 994B relating to this Agreement in accordance with generally accepted surety industry underwriting practices. Said Form is incorporated herein by this reference."

Ms. Clark confirmed the ownership of other assets and obtained credit references from banks and suppliers. She did not confirm the ownership of the 13 houses which represented approximately 70 percent of Mr. Wyatt's net worth as of February 14, 1979. Also, there was no confirmation and reconciliation of Wyatt's financial statements to his individual income tax returns as none were secured. Ms. Clark stated that her company does not require copies of tax returns and, to her knowledge, the only surety companies who required them were the standard companies.

## Inadequate Reporting of Claims Information by UIB

Our examination disclosed that default notices, status reports and recoveries were not submitted to the SBA in a manner provided for in the Guarantee Agreement. The result is that SBA's records are untimely, inaccurate and do not disclose recoveries due.

- ### Default Notices were Not Timely

Our examination disclosed that the SBA was not notified of defaults within 30 days as provided by the Guarantee Agreement in three of the four claims examined.

Paragraph 6 of the Terms and Conditions of the Guarantee Agreement (SBA Form 990 (8-76)) addresses the requirements for default notices. It provides:

> "...If any suit or claim is filed against Surety upon said bond(s), Surety shall inform SBA of the same within 30 days of reciept of notice thereof in the Surety's home office. Unless SBA decides otherwise, and so notifies Surety within 30 days of reciept from Surety of such notice..."

In this case, the surety has defined the term "notice" to mean the earliest correspondence in the file regarding each bond.

In our opinion, the proper definition would be the earliest indication of default on any uncompleted contract (bond). That date was May 14, 1979. We believe this definition is appropriate in this case because:

- The principal walked off the job and was behind in payments of wages and materialmen.
- The principal was rumored to be filing for bankruptcy.

These allegations should have been serious enough to cause an investigation of all uncompleted contracts. Since the cost of investigation will result in a claim we, believe a default occurred at this time.

An analysis of the dates of default using the sureties definition follow.

| SBG Number | Date of First Status Report | Default Date Sureties Definition |
|---|---|---|
| 0900-00782-004-51 | 5/30/79 | 5/23/79 |
| 0900-00782-005-53 | 7/ 3/79 | 5/24/79 |
| 0900-00782-007-57 | 7/ 9/79 | 6/25/79 |
| 0900-00782-011-46 | 6/25/79 | 5/14/79 |

Using the sureties definition, the SBA was promptly notified in 50 percent of the cases (2 of 4) and, using our definition, the SBA was notified in 25 percent of the cases (1 of 4).

This finding was discussed with Mr. Perry Lisker of UIB. He stated that without clear definitions the actual date of default became subjective but that his staff was improving its responsiveness on this problem as each day passes.

## Status Reports

In each of the claims examined, the SBA did not receive a status report every six months as required by the Terms and Conditions of the Guarantee Agreement. More importantly, the surety has not clearly disclosed the fraudulent actions of the principal in securing this bond.

Paragraph 9 of the Terms and Conditions of the Guarantee Agreement (SBA Form 990 (8-76)) expresses the SBA's need for current status reports. It states:

> "... Surety shall be entitled to reimbursement for its loss covered by this Agreement, adjusted pro rata for payments received by Surety from any other source, within 90 days of actual receipt by SBA of an appropriately documented payment request, including vouchers or other evidence of loss by

> Surety, a notice that Surety has established a claim reserve on the default, and current status report (including salvage prospects) on the Contract..." (emphasis supplied)

The Surety Bond Guarantee Division currently requires status reports every six months.

As of August 29, 1980, the following were the dates of the status report mailed to the Surety Bond Guarantee Division.

| SBG Number | Initial Status Report | Follow-Up Status Report(s) | Months Between Status Reports |
|---|---|---|---|
| 0900-00782-004-51 | 5/30/79 | 6/6/80 | 12 |
| 0900-00782-005-53 | 7/ 3/79 | 8/8/80 | 13 |
| 0900-00782-007-57 | 7/ 9/79 | 6/6/80 | 11 |
| 0900-00782-011-46 | 6/25/79 | 6/2/80 | 11 |

- Inadequate Disclosure Of Fradulent Application To SBA By Surety

We believe UIB has not adequately disclosed the fraudulent nature of Mr. Wyatt's bond application to the SBA.

Paragraph 14 of the Terms and Conditions of the Guarantee Agreement (SBA Form 990 (8-76)) provides the criteria for full disclosure of all facts in a claim. It states:

> "Any intentionally false statement or willful misrepresentation in connection with the procurement of the Guarantee or claim for payment pursuant to this Agreement is a violation of federal law, subject to criminal and civil prosecution under 18 USC Sections 287, 371, 1001, 15 USC Section 645, and 31 USC Section 231, carrying fines up to $10,000 and imprisonment of up to five years."

By letter dated May 5, 1980, the surety's outside attorney, Michael Bassin, advised Mr. Stanley Haren of UIB of the following:

> "In discussing the matter with Doris (Clark), we arrived at one option, to wit, that the undersigned prepare an indemnity complaint and have the Contractor's Board summon Mr. Wyatt to their office at which time, you guessed it, service will be effected. Please review all of the attached materials as, I must confess to you. I've got a real pistol on for this case. Mr. Wyatt defrauded American Fidelity and its agents by indicating great real estate holdings. Immediately after the default, I did my own telephonic investigation with various officers of title companies who reported that Mr. Wyatt owns nothing in any county south of Santa Barbara. Therefore, my preparation of

an indemnity lawsuit wouldlso entail allegations of fraud (intentional misrepresentaon) as well as intentional omission (Mr. Wyatt knew full well that s. Clark was relying on the attached financials in issuing the hds.)"

The following are excpts of Status Reports to the Claims Manager of the Surety Bond uarantee Divison. As of August 29, 1980, the SBA had not been fully vised of the gravity (fraud) of the principal's action.

Iemnity

"Although the inial review of the financial statement submitted by the princal indicated substantial real estate holdings, a subsequentitle search conducted by the Surety in those counties where sd property was allegedly located, has shown that, in fact, tre is no property owned by the principal or the indemnitors in ose counties. In view of the fact that the Surety has been unle to make any contact with the principal or the indemtors and that there are apparenly no viable assets to procee against for salvage recovery, it is anticipated that there s minimum chance of indemnity recovery on this file.

As more informatic becomes available and should the status of this matter change, ou will be immediately notified."

(Source: ~~-~~ Status Report dateJune 25,1979 SBG 0900-00782-011-46)

"Default occurred en the principal fled the job site under extremely mysteri s circumstances in May of 1979. At that time he announced a number of people that he was filing bankruptcy, however, thSurety has never received notification of any bankruptcy.

The Surety is currtly going after the principal and its personal indemnitors toecover the Surety's losses. The Surety has hired a private invtigator to locate these indemnitors to no avail, however, one the indemnitors is presently licensed in the State of Nevada d said license was renewed in January of this year. The Suret is presently working with the Nevada State Contractors Licens Board to try to effectuate service upon him. Your office ll be further updated in this regard also."

(Source: Status Report dateugust 8, 1980, SBG 0900-00782-005-53)

We discussed this matter with Mr. Lisker, Claims Manager of UIB. He agreed that the status reports were not timely and stated he is working on the problem. Second, he stated there were two reasons for the inconclusive disclosures on the actions of the principal. They were:

- An attorney in California is barred from threatening criminal actions in a civil proceeding. Mr. Lisker was concerned that advising the SBA of the facts present in this case could be translated by program officials into a threat on the principal.
- To Mr. Lisker's knowledge, the SBA has never set policy on the course to follow in fraudulent representations. Should, for example, the surety pursue this matter civilly and recover whatever recoveries possible or would it be better to prosecute the principal. Mr. Lisker reasoned that the prosecution of the principal would likely mean that the principal's attorney would get whatever assets Mr. Wyatt retained while the SBA and surety would get nothing.

At that point, Mr. Lisker thought it would be useful to interject some observations made by outside counsel on the problems UIB faced with full disclosure to Surety Bond Guarantee personnel. The following excerpts state the disclosure dilemma UIB believes it faces. This letter was recently released to program officials.

> "SBA Furnished Opposing Counsel With Our Reports
>
> We write this report with some trepidation because we have found that two of our previous status reports to the SBA have been furnished to our opposing counsel in response to a Freedom of Information Act request after the court had ruled that opposing counsel was not entitled to discovery of the reports and that United Inspection Bureau was therefore under no duty to turn over its copies. In view of the SBA's considerable

> interest in the successful outcome of this litigation, we request that a legal review be made of the discoverability under the Freedom of Information Act of this correspondence. If it is determined that the correspondence is not properly producible in response to a Freedom of Information Act request, and if steps are taken to make sure that such correspondence does not fall inadvertently into the hands of opposing counsel, we will be able to discuss developments in the case freely. As it is, we will have to limit this report to a straightforward statement of recent developments and will include little or no evaluation of the case or discussion of tactics and strategy since experience suggests that every word of this letter may be read by our opponents."

On November 21,1980, we discussed this matter with the Claims Manager of the Surety Bond Guarantee Division. He advised us that in his opinion the requirement to fully advise the SBA of fradulent transactions was at least implied in the Guarantee Agreement. He stated this matter would be clarifed in the claims manual his office is in the process of writing.

- Recoveries not Remitted to SBA in 90 days

The surety did not remit recoveries on SBG 0900-00732-005-53 in 90 days as required by the Guarantee Agreement.

The next to last sentence of paragraph 9 of the Terms and Conditions of the Guarantee Agreement (SBA Form 990 (8-76)) provides:

> "If any net amount (less deductible) is recovered by Surety from any other source after payment has been made by SBA, SBA is entitled to receive up to 90 percent of said net amount within 90 days of actual receipt by the Surety."

Our examination disclosed that a balance due SBA of $6,199.42 as of June 20, 1980, was not remitted within 90 days. According to Ms. Jo Christner of UIB, there was a remaining balance due SBA on this bond of $547.00 as of October 1, 1980. The balance of these funds was used to pay claim costs.

## SBA Reimbursement of Administrative Expenses

Unallowable administrative costs of $2,549.70 incurred by the surety are not reimbursable by SBA.

SBA defined unallowable administrative costs in a directive dated May 15, 1973, which stated the following:

> "... we feel reimbursable loss does not include surety salaries or normal administrative costs of a claims department ..."

AFF does not have a claims adjusting department. All claims are adjusted by UIB, an outside claims adjusting company. UIB provides the same services that would be available to a surety company internally, if a full functional claims department was maintained.

As of June 20, 1980, AFF has incurred $2,549.70 of UIB claims adjusting expenses. We believe these expenditures are administrative costs of AFF and not reimbursable by SBA. To resolve this matter, we have referred this question to the Office of General Counsel and await its decision.

## Miscellaneous Fees Due SBA

Our examination disclosed a net of five dollars was due the SBA as a result of change orders.

Paragraph 4 of the Terms and Conditions of the Surety Bond Guarantee Agreement (SBA Form 990 (8-76)) require the SBA to make adjustments on bond premiums for change orders. It states:

> "Surety shall pay SBA 20 percent of its bond(s) premium. Surety will pay SBA an additional like percentage of the additional premiums collected on any Contract amount increase of more than $5,000, and SBA will make a like percentage refund on any premium reductions resulting from a contract amount decrease of more than $5,000."

Similarily, SOP 50-45 (8-1-73) Paragraph 14 a. and e.(2) requires adjustments in SBA's Guarantee Fee's for change orders over $5,000.

## FACT SHEET

| | |
|---|---|
| Principal: | Western Environmental Landscape Systems<br>Torrance, California |
| Obligee: | Los Angeles County |
| Surety Bond Guarantee Number: | 900-96186-001-64 |
| Surety: | American Fidelity Fire Insurance Company<br>Woodbury, New York |
| Underwriter: | Market Insurance Corporation<br>Encino, California |
| Claims Adjuster: | United Inspection Bureau<br>Encino, California |
| Cost of Original Contract: | $490,785 |
| Loss to SBA: | $100,424 |

## BACKGROUND

On June 8, 1976, SBA entered into an agreement with American Fidelity Fire Insurance Company (AFF) to guarantee a surety bond on a contract requiring Western Environmental Landscape Systems to develop a recreational vehicle park for the County of Los Angeles. The term of the bond was July 7, 1976 to July 7, 1977.

The owner of the land, V.J.R.S. Industries of California, was named as a dual obligee on the bond with the County. On January 5, 1977, SBA was notified by the surety that the contractor had defaulted. The default was caused by differences between V.J.R.S. and Western regarding progress payments and liability for funds owed suppliers. At the time of default, Western had claims against it from suppliers totaling more than $300,000.

The surety settled the claims for $35,000. However, the total cost to SBA, including legal expenses, was $100,424.

## FINDINGS

The SBA Office of Inspector General and staff of the Senate Small Business Committee conducted separate investigations of this case. The investigations found an apparent scheme to circumvent

SBA Standard Operating Procedure (SOP) 50-45, which prohibits bonding of owner-builder companies. The SOP requires a clearly established contractural arrangement between two parties. Because an onwer-builder cannot have a clearly delineated two-party contract, there would be an inherent conflict-of-interest in such a situation.

In April 1976, Jack Bryan, President of V.J.R.S., tried to obtain a bond guaranteeing his own company's construction of the recreational park through the Safeco Insurance Company. Bryan's application was denied because Safeco would not write surety bonds for owner-builders.

In May 1976, Bryan was referred to an agent for AFF. The agency informed Bryan that AFF also would not bond owner-builders because of the SBA regulation.

Meanwhile, construction on the project had begun in April with V.J.R.S. acting as the prime contractor.

On May 26, 1976, Bryan contacted the same agent for AFF again. Bryan informed the agent that he had found Western to perform the work, and requested a bond for the contractor. The agent was shown the contract between V.J.R.S. and Western, which was dated April 1, 1976, nearly two months before the bond application was submitted and the time during which V.J.R.S. was asking the agent for a bond on its own company to guarantee performance of the work.

The application was submitted to AFF and SBA. The bond was approved and issued on July 7, 1976.

The facts indicate that the contract between V.J.R.S. and Western was a sham, conceived for the purpose of demonstrating a two-party contract, and to conceal that V.J.R.S. wanted a bond that had already been denied. V.J.R.S. was always in control of the construction project. The bank account used to disburse funds for construction was in the name of V.J.R.S. Bryan personally controlled all funds to subcontractors, authorized all purchase orders and supervised all physical aspects of construction. Key employees of V.J.R.S., who were interviewed by the Inspector General, stated that Bryan was running the project. A private investigator hired by AFF interviewed various suppliers and subcontractors on the job. Of 47 companies or individuals contacted, only five knew Rex Melton, the principal of Western.

Two days after the bond was approved, Bryan removed Melton from his job. V.J.R.S. employees were placed on Western's payroll. Another of Bryan's companies, Eastern Shore, operated the park for the next ten months. V.J.R.S. made payments for all surety bond and application fees.

The investigation also found underwriting deficiencies concerning this bond on the part of AFF and its agent, Market Insurance Corporation. The contract, dated April 1, 1976, required that the contractor provide payment and performance bonds before work commenced. Work began in April, but the bond was not issued until July 7, 1976. This information was available to the surety, but was not considered.

The principal of Western answered yes to the question: "Have you ever been charged with or arrested for any criminal offense other than a minor motor vehicle violation?" The surety did not require the principal to furnish details of the arrest, which could have had an impact on approval of the bond.

In addition, the surety did not analyze the principal's financial statements, did not evaluate contract costs, did not review the contractor's professional history and did not require copies of the contractor's tax returns. Paragraph two of the SBA Surety Bond Guarantee Agreement states: "Surety represents that such bond or bonds when executied by it as to terms and conditions will be in accord with those executed by professional sureties..." Professional sureties require the items which were not provided by AFF in this case.

Bryan's whereabouts have been unknown since August 1981, when he disappeared after defaulting on the project.

Bond # 1332 5 2

SMALL BUSINESS ADMINISTRATION

## GUARANTEE AGREEMENT UNDER TITLE IV, PART B, OF THE SMALL BUSINESS INVESTMENT ACT OF 1958, AS AMENDED

This agreement, made and entered into this 8th day of June, 1976

by and between the Small Business Administration, an agency of the United States Government, hereinafter referred as SBA and

American Fidelity Fire Insurance Company, hereinafter referred to as Surety,

relative to Western Environmental Landscape, hereinafter referred to as Principal,

who has applied for bonds required for trail park construction for Bonelli Regional Park OBLIGEE: Los Angeles County 120 Days completion time
(describe project)

WITNESSETH: That in consideration of the mutual convenants and agreements herein contained, the parties agree as follows:

1. Surety agrees, conditional on the execution of this guarantee by SBA, to become surety on the bid bond and if Principal's bid price is in line with other bidders in Surety's opinion and the contract price does not exceed $500,000, to become surety on performance, payment, maintenance, or any other bonds necessary or incidental to the performance of the above described contract executed on behalf of the Principal. The agreement in this paragraph shall not apply unless all prescribed underwriting conditions are met, nor shall it apply if subsequent or additional information comes to the attention of the Surety of a nature to change its underwriting decision as to the desirability of executing any of the aforementioned bonds.

2. Surety represents that such bond or bonds when executed by it as to terms and conditions will be in accord with those executed by professional sureties for the type of contract for which such bond or bonds are required to be furnished by Principal.

3. Surety affirms that without this SBA guarantee to Surety it will not issue any of said bonds to Principal.

4. SBA hereby agrees to guarantee to Surety 90% of any "loss" Surety may sustain or incur in good faith by reason of its execution of the bid, payment or performance bond contemplated by this Agreement.

5. SBA agrees that the term "loss" as used in this Agreement shall mean any and all liability, damages, court costs, counsel fees, charges and expenses of whatever kind or nature which the Surety shall or may, at any time, sustain or incur by reason, or in consequence, of having executed the bond or bonds herein guaranteed by SBA.

6. The Surety shall be entitled to credit for any and all disbursements, in and about the matters herein contemplated, made by it in good faith under the belief that it is or was liable for the sums and amounts so disbursed, or that it was necessary or expedient to make such disbursement (including efforts to diminish "loss"), whether such liability, necessity or expediency existed or not, and vouchers or other evidence of such disbursement shall be taken as prima facie evidence against SBA of the fact and extent of SBA's liability to Surety.

7. SBA agrees that Surety shall be entitled to reimbursement on a calendar quarterly basis under this guarantee for its loss, adjusted pro rata for any payments received by Surety from any other source.

SBA FORM 990 (3-72) PREVIOUS EDITIONS ARE OBSOLETE

9 JUN 1976

8. Surety agrees that if any suit or claim is brought or instituted against Surety upon said bond or bonds, Surety shall inform SBA of the same within a reasonable time of receipt of the summons and complaint or claim in the Surety's home office. Unless otherwise agreed, Surety shall take charge of all claim matters arising under said bonds; determine its liability and the amount thereof; compromise, settle or defend any claim or suit; and, take such action as it deems necessary to minimize loss.

9. Subsequent to the signing of the contract by the parties obligated thereon and the execution of the bonds guaranteed herein, no act or omission of the Surety in modifying, amending, limiting or extending any instrument executed by the Surety, nor the execution of any consent to the contract or bond(s) herein referred to, shall in anywise affect the liability of SBA hereunder, nor shall SBA be released from this obligation by reason thereof; and it is further agreed that Surety may thereafter alter, change, modify, amend, limit or extend any instrument or may execute renewal thereof, or other and new obligations in its place or in lieu thereof without notice to SBA, and in such case SBA shall be liable to Surety as fully and to the same extent on account of any such altered, changed, modified, amended, limited or extended instrument or such renewals thereof, or other or new obligations in its place or in lieu thereof, as fully as if such instrument were described at length herein.

10. Surety agrees to pay SBA 10% of its bond(s) premium for and in consideration of SBA's agreement to guarantee the bid, payment or performance bond contemplated by this Agreement. It is further agreed by SBA and Surety that Surety will pay SBA an additional like percentage of the additional premiums collected on any increase in contract price and SBA will make a like percentage refund on any premium reductions resulting from a reduction in the contract price. Where SBA or Surety's share of any additional premium increase or decrease is Five Dollars ($5.00) or less, there shall be no adjustment.

IN WITNESS WHEREOF, the parties have caused this Agreement to be executed the date and year first above written.

American Fidelity FireIns. Co.
SURETY
By Paul Walaski
Paul Walaski
Attorney-in-Fact

SMALL BUSINESS ADMINISTRATION 23 JUN 1976
By

SBA w/Suffix: 96186-01 (SBA)
Surety #: (Surety)
Project Advertised? ☐ yes ☐ no
Date Contract Awarded:
Contract Award Amount:
Negotiated? ☐ yes ☐ no
Bid Spread - 1 st:$
2nd:$
3rd:$
Project for Public Sector? ☐ yes ☐ no

Amount of Contract $ 490,735.00
Date 4-1-76

Bond Amount: Bid ______ Performance 100 Payment 100
Date 4-1-76
Premium Charged (and % Rate) $6,157.85
Scheduled Contract Completion Date 120 Days

3

LAW OFFICES
BARRY BERNSTEIN
KENT L. VALLETTE
8500 WILSHIRE BOULEVARD SUITE 521
BEVERLY HILLS, CALIFORNIA 90211

BARRY BERNSTEIN
KENT L. VALLETTE
E. LEONARD FRUCHTER
OF COUNSEL
RICHARD GOLDSTEIN

AREA CODE 213
TELEPHONE 659-2221

November 29, 1976

HECTOR VASQUEZ

DEC 13 1976

Mr. Perry Lisker
Market Insurance Corporation
3550 Wilshire Boulevard
Suite 1200
Los Angeles, California 90010

RE: American Fidelity Fire Insurance Company
Principal : Western Environmental Landscape
Bond Number : 04-206-1338305

Dear Mr. Lisker:

The following is my initial status letter to you on a matter that was assigned to me on October 18, 1976. The matter is most complicated but the prognosis is optomistic.

THE BOND:

The bond in this instance is in the penal sum of $490,785.00 and was issued on July 7, 1976, on the American Fidelity Fire Insurance Company Contract Bond-California Private Work form. The principal is Western Environmental Landscape System and the named obligee is V.J.R.S. Industries, Inc. By a rider to the bond the County of Los Angeles was added as an obligee.

The bond contains the following conditions and stipulations which will work to our benefit:

1. No right of action under the bond shall accrue to any person other than the named obligees. As you will see hereafter we are aware of unpaid suppliers on the project having claims in excess of $300,000.00;

2. Condition "First" of the bond requires ten days written notice to the surety of any claimed default by the principal. The first written notice was sent by the obligee by its attorney Steven Rein of the firm of Clifford S. Dicker, on October 13, 1976;

3. Condition "Second" of the bond requires that the obligee retain ten percent of the contract amount for the benefit of the surety;

4. Condition "Fourth" states that "if there be more than one obligee named in this bond, then it is understood that the rights of the Obligees or any of them under this bond are conditioned upon the faithful performance by or on behalf of the owner of all of the conditions of the contract by him to be performed." As we will see hereinafter, the owner of the project has been in breach of the contract since, literally, before its inception, assuming that the contract was valid. I believe that it can be proven that the contract which we bonded was a sham.

## THE OBLIGEES:

V.J.R.S. Industries, Inc. is a California corporation in good standing. The moving force behind the contract appears to be a gentleman named Jack Bryan who introduces himself as its President. Mr. Fruchter of our firm and I had extensive meetings with Mr. Bryan and the attorney for V.J.R.S. Industries, together with several employees of V.J.R.S. in Mr. Rein's office on October 20th and 21st, wherein much of the information contained in this report was learned. These meetings were tape recorded and I have prepared a transcript of the meeting of the 20th. A copy of that transcript accompanies this report.

Mr. Bryan informs me that V.J.R.S. Industries was incorporated in 1971 as a new company, not the successor in interest to any prior business. He relates that it does business under three different fictitious names:

1. East Shore Recreational Vehicle Park;
2. W. E. Hutton and Company - A Mortgage Investment Operation;
3. Continental Pacific Associated Inc. - A Mortgage Banking Concern.

THE PROJECT:

On March 25, 1976, the County of Los Angeles, entered into a lease with V.J.R.S. Industries, Inc., wherein the County as lessor let a section of the Frank G. Bonnelli Regional Park to V.J.R.S. Industries on a 25 year ground lease. A copy of this lease together with a letter of February 26, 1976, from Steven J. Koontz, Director of Facilities, directed to the Board of Supervisors recommending adoption of the lease, is attached hereto for your consideration. This lease was not, apparently, presented to underwriters.

Essentially, the lease requires V.J.R.S. Industries to take possession of the premises at Bonnelli Park and construct 189 recreational vehicle spaces together with four comfort sta tions, sanitary disposal pump stations, a general store, laundry facilities, landscaping, and other accoutrements.

Paragraph 14 of the Lease (page 10), requires V.J.R.S. Industries, Inc. to post certain performance and surety bonds on the projett. The lease seems to contemplate that V.J.R.S. would construct the improvements themselves as owner/builder and requires that V.J.R.S., no less then 10 days prior to commencement of any construction, post 50 percent performance bond and 50 percent payment bond insuring the construction of the improvements required by the lease and insuring payment to suppliers of the project.

The lease provides that should the lessee employ a licensed contractor for the construction of the improvements, the lessee may obtain from the contractor bonds in similar amounts wherein the County may be named as obligee in lieu of bonds from V.J.R.S. itself.

The letter from Facilities to the Board of Directors also states, of interest, that "the key element to success by a private developer in this project, in addition to the expertise necessary to engineer and construct the campground, is the ability to finance the program. V.J.R.S. has on record a letter from the American National Bank of Bakersfield valid for 45 days from February 18, 1976 stating a loan of

$600,000.00 is available pending approval of its finance committee and an award of the lease." The surety was, therefore, aware at the time the bond was written of the involvement of the American National Bank in the project as financial lender.

THE PRINCIPAL:

The principal under the bond is Rex E. Melton, Jr., doing business as Western Environmental Landscape Systems. Mr. Melton has a license for irrigation and landscape.

The General Agreement of Indemnity purports to have been signed by Rex E. Melton, Jr., and Patricia Marie Melton, his wife, purports to have been executed on May 26, 1976, in the presence of a Notary Public named Sybil D. Crawford. Mr. Melton admits that he executed the agreement but denies that his wife signed it. Of no small note is the fact that Sybil D. Crawford is the wife of Jack Bryan and that Ms. Crawford was formerly, within the very recent past, an officer of American National Bank associated with their loan department.

Mr. Melton is being very cooperative and met with me for more than 3 hours on the morning of October 20, 1976. As you will learn below, Mr. Melton tells a story very different from that of the obligee regarding the status of the project and the alleged default.

THE BANK:

The financial institution involved here is American National Bank of Bakersfield, and its wholly owned subsidiary known as American National Mortgage Company. There is a letter in the underwriting file dated May 25, 1976, addressed to American Fidelity Fire Insurance Company advising that American National Bank has recorded a loan to V.J.R.S. Industries, Inc. for the construction of a recreational vehicle park, San Dimas, California, and that loan funds will be disbursed only on voucher and subject to inspection of progress by the bank. As you will see hereafter and based upon the authority of Mendosa vs.

Commercial Standard Insurance Co., 57 CA 3d 241, 129 C.R. 91, (1976), American National Bank may be liable to American Fidelity Fire Insurance Company for improper disbursements from the construction account.

## HISTORY OF THE PROJECT

The principal and the obligee tell divergent stories. Each agrees that no work was done on the project after September 2, 1976. This is quite important when you consider the notice provisions of the bond:

### A. REX MELTON's PROSPECTIVE:

On October 19, 1976, I telephoned Mr. Melton at his home and he agreed to meet with me at my office the following morning. In a tape recorded meeting he layed out for me his total prospective on the project and handed me a type written statement which was transcribed during a meeting that he had with representatives of American National Bank in Bakersfield in the middle of September. A copy of this statement is forwarded to you together with this report.

Mr. Melton explained that he was introduced to Jack Bryan by Mr. Don Byron a mutual friend. This introduction occurred in February of 1976. Bryan told Melton that he would like to have a rough bid from him for the irrigation grading and structures on the Bonnelli Park Project that Bryan could take to the County as part of the lease negotiations. Melton stressed that Bryan did not ask him for a firm bid that he would stand behind but only for some guide lines for use in negotiating with the County.

Mr. Melton explained the layout of the park as a clover leaf shaped project with the loops of the leaf being built around three hills. The hills were to be planted and the camp sites were located on the roads around the hills.

Sometime in February, Melton attended a meeting at the offices of the Facilities Department of Los Angeles County. After this meeting Bryan told Melton that he "had the job" to design and construct the park. Bryan asked Melton to start the design work for which he would be paid $150.00 per day.

A Second Meeting was held in February with the County, where Jack Bryan and Melton were present. Bryan told the County that the park would be completed by July 4, 1976. The County said that this date was not necessary and the County suggested a September 4, 5, or 15, completion date.

Melton prepared the following "guestemate" for the costs:

1. $135,000.00 for plants, shrubs and soil preparation;
2. $ 65,000.00 to $ 85,000.00 for a fully automatic irrigation system including trenching.

This guestemate was not based on the plans and specifications. After Melton saw the specifications, he increased the landscaping estimate to $165,000.00.

Bryan's offer to Melton was that Melton would oversee the construction of the project as a supervisor - not as the contractor - and that Melton would be compensated as follows:

1. Bryan would arrange financing for a nursery that Melton wanted to build in Costa Mesa;
2. Melton would be paid a per diem for working on the project;
3. Melton would be paid a rental for his backhoe, trencher, trucks, etc., which were used on the project;
4. Melton would receive 5% of the park revenues for the period of the lease-25 years.

Melton stressed that this compensation was for the "use of his license" and for supervision of the project all of which was being done by Bryan as an owner/builder.

As it worked out, Melton was not even a supervisor on the project. Jack Bryan ran everything and his brother, Roy Bryan, was the No. 2 man on the job and Melton was No. 3.

The job started around April 15. For the first 5 days Melton did some grading which consisted of removing the top three hills and creating flat pads on the top. Bryan estimated this to cost less than $10,000.00 and the actual cost was $ 6,000.00. Bryan also promised Melton that he would have 20 percent of any savings which were realized during the construction project. The job worked in this way for 5 days and shut down by the County. It started again on May 11, 1976.

When the first payment draft was received from the bank it was taken by Bryan and Melton to the Sumatomo Bank in Torrance, Melton's bank. Of the first draw everything over the actual costs were put into a Cashier's Check made out in the name of Bryan's Mother. Melton was reimbursed for his payroll, $ 3,038.87.

The same procedure was followed with the second and third drafts. After this, no draft was ever made to Melton's company.

Melton stressed that all of the contracts on the project with the suppliers and subcontractors were made in the name of V.J.R.S. and not Western Environmental Landscape Systems or Rex Melton. Melton signed none of the contracts and did not issue purchase orders.

During July the following occurred: The project was not ready to be opened on July 4th. Jack Bryan decided to expedite opening by laying sod rather than following the method required by the plans and specifications of soil preparation, mulch and seeding. This was done against Melton's advice.

On July 9th, 40,000 square feet of sod were put down over raw unprepared ground. Bryan ordered the sod from Cal-Turf of Camarillo in his own name. Melton refused to lay the sod and Bryan threw him off the job.

July 10th, was the ceremonial opening for this area of the project. At the time of the opening Bryan told Pennington and Klaus of the County that Melton was off the job. The following Monday (approximately July 12) Melton was called back to the job by Jack Bryan. Since Melton refused to have anything to do with putting down the sod Dale Zinn a subcontractor of V.J.R.S. was put in charge of this part of the project. Melton estimates that 133,000 square feet of sod had been put down on the job at 15 cents a square foot. As of August, all of the landscaping and irrigation systems were installed on hills 'A' and 'B' and the project was complete as to hills 'A' and 'B' with the exception of there being no adequate soil preparation. Also, some of the grass had deteriorated, and some weeding and fertilization needed to be done. As of this time, no work had been started on hill 'C'.

In order to save money for grass on the hillside areas, Bryan decided not to use the Stasoil Company from whom a bid had been selected. There was a contract between Stasoil and V.J.R.S. which provided that Stasoil would mulch and seed for 3 cents a square foot providing the whole project could be done with one move-in. Since it could not be done with one move-in, Stasoil wanted 6 cents a square foot therefore, Bryan decided to buy a "Spray Baby" mulching machine from the manufacturer in Carson City, Nevada, to mulch and seed the hills themselves. Therefore, $ 5,602.70 was paid out of the construction funds to buy this piece of equipment, title to which went into the name of Rex Melton with the consent of Bryan. Melton was to retain the machine after the project was concluded as part of his compensation. Conweb Corporation of Los Angeles supplied the mulch and Burpee Seed of Riverside supplied the grass seed.

After planting Melton advised Bryan not to open the project until the grass seed had had at least one month to take hold. Bryan refused to follow this and opened the park immediately.

The last day Rex Melton was on the job was September 2, 1976. He told Bryan that unless all of the bills were paid by September 7th, he would not come back to the job at all under any circumstances.

Melton met with the County sometime around September 10th through the 15th and, told them the whole story and met with the bank on September 14th and told them the story also.

Melton gave me a list of bills that he is aware of totaling some $245,000.00:

| | | |
|---|---|---|
| 1. | Top Pipe | $ 27,000.00 |
| 2. | ABC Nursery | 4,500.00 |
| 3. | Burpee Seed | 2,300.00 |
| 4. | Conweb | 1,500.00 |
| 5. | K&R Backhoe of Torrance | 14,000.00 |
| 6. | Vernon Paving | 61,000.00 |
| 7. | Cal-Turf | 20,000.00 |
| 8. | Inland Pipe and Supply of Riverside (Don Fife) | 26,000.00 |
| 9. | Aqua Swim | 14,500.00 |
| 10. | Zinn | 20,000.00 |
| 11. | Pasley | 26,000.00 |
| 12. | Jerry Asher-Venice | 2,000.00 |
| 13. | Action Rental | 5,000.00 |
| 14. | Electrical Supply | 15,000.00 |
| 15. | Bob Masonry-San Dimas | 3,000.00 |
| 16. | Lomita Trenching | 2,700.00 |
| 17. | Roofing | 2,700.00 |
| 18. | (Benches and Concrete accessories) | 2,330.00 |
| 19. | Rex Melton - 119 Days at $150 per day - Less Payment received of $ 7,000.00 | 17,850.00 |
| | | $ 254,780.00 |

This is essentially the same story that Melton gave to the bank. Melton also sat down with the County in the middle of September and told them the same story.

B. V.J.R.S. PROSPECTIVE:

The position of V.J.R.S. was set out in two meetings and held in the offices of their attorney, Steven Rein, on October 20, 1976 and October 21, 1976. Present at the meeting were Jack Bryan, Sybil Bryan, Steven Rein, Esquire, William "Tom" Harden, Dan Regan, Leonard Fruchter, and myself.

We were informed that the project was 90 percent complete and that V.J.R.S. had acquired a cost take-off by a potential completing contractor: Charlie Clark of 3-D Services of El Monte. This bid is for $118,000.00 and a copy of it is forwarded herewith.

Bryan told me that the contract documents consist of the written contract form together with plans and specifications prepared by Marine Consultants of Newport Beach. Bryan says that these plans and specifications were submitted to the County and were approved for installation on April 15, 1976. Bryan said the physical work on the project began on April 23, 1976, when Western Environmental moved onto the job site and began rough grading through Melton's subcontractor Lloyd Henry Company.

When questioned on the bidding procedure, Bryan told me that the project was advertised in the Green Sheets during March of 1976 and that the project was solicited as a one hundred percent contracted project by V.J.R.S. I questioned Mr. Bryan as to his list of bidders and he told me that 15 sets of plans went out and that 3 bids were received for the entire project and some 50 bids were received on various parts of the project.

The 3 bids for the entire project were according to Bryan:

1. Rex Melton and Greg York doing business as Western Environmental - $463,000.00 or $465,000.00 - (submitted orally);

2. Don Byron - $583,000.00 or $593,000.00 - (also oral);

3. A bidder whose name Mr. Bryan could not remember who submitted a written bid in an amount that Mr. Bryan could not recall.

Bryan said that for the first 45 days there were no problems on the project. During April and May everything was proceeding satisfactorily and the project was working double shifts, aiming for a July 4th completion date. Bryan says that the only displeasure he experienced was that the project should have been physically started on April 10, 1976, 10 days after the written contract was allegedly signed.

Then, Bryan related, in June, Mr. Melton's checks began bouncing and subs would not move on the job. Melton allegedly told Bryan that Western Environmental could not get materials on the project because of Western Environmental's poor credit.

When the pace of construction fell off between June 1st and June 10th, Mr. Bryan at the insistance of the stockholders of his company, moved onto the job site to oversee the construction schedule. On June 15th, Jack Bryan moved into the Lemon Tree Motel in the area and in his words, his object was to "ride herd" on the job.

Bryan says that between June 15th and June 30th, he was on the job from 6:30 a.m. to 6:30 p.m. Also during this period of time, Mr. Bryan took himself off the payroll of V.J.R.S. Industries because he was devoting all of his time to this construction project and put himself onto Melton's payroll. It appears that not only did Mr. Bryan put himself on the payroll but also put his brother, Mr. Roy Bryan, on the payroll together with Marilyn Valence, Mr. Jack Bryan's personal secretary. Mr. Dan Regan, Mr. Bill Pilot, Mike Witteous, Abe Boltt, all of V.J.R.S., and two of Jack's step-sons were put on the payroll of our principal (in Mr. Bryan's words) together with a Mike Langdon who Mr. Bryan described as V.J.R.S.' "office boy".

I questioned Mr. Bryan as to the propriety of his putting his entire staff on the payroll of our principal and he said that on June 15th Rex Melton said that he needed help with the project because it was bigger than anything he had ever handled before and he just didn't have the expertise to handle it. Bryan says that Melton agreed to pay Bryan $500.00 per week (net) and that the first two checks given to Bryan bounced.

Bryan said that work on the project now went smoothly until June 30th, when the project was still not prceeding smoothly because Rex Melton was not spending all of his time on the project and was diverting some of his energies to a project at Torrance Memorial Hospital. Therefore, on June 30th, Jack Bryan told Rex Melton that all future vouchers would be joint checks and that Melton's payroll would be paid by V.J.R.S.

(Bryan asserted that Melton used money received on the job to make payments outside the job and that one of the purposes for construction funds was a $ 4,000.00 diamond ring that Melton allegedly purchased for his Wife.)

(Bryan also offered that the "mortgage banking division" of V.J.R.S. received a $12,000.00 fee for arranging a part of the construction loan on the project. American National Bank and its mortgage unit are merely servicing the account and the funds for the project, in the amount of $450,000.00 were arranged by V.J.R.S. from the Northwestern Savings and Loan in St. Louis, Missouri. The source of the additional $150,000.00 mentioned in the letter from the bank is not clear.)

On June 23rd, the Operating Engineers of Local 12 and the Laborer's Union put up a picket line because Melton was not a Union Signatory. Bryan says that V.J.R.S. signed an agreement with the Operating Engineers-Local 12 and that the line ended.

On June 30, 1976 Bryan learned that Melton did not file his first quarter withholding return. This is of no real significance since none of Melton's crew were on this project during the first quarter of 1976.

Bryan relates that during the month of July production was up but the project was still about 15 days off schedule.

During August the County was pleased with the construction on the park. In mid-August Rex Melton first told Bryan about his nursery project and Jack Bryan, out of the goodness of his heart, took two days off the construction project and went with Mr. Melton to St. Louis to the Northwestern Savings and Loan to discuss financing for the nursery for Mr. Melton "as a favor to Mr. Melton".

Then, on September 1st, Rex Melton abandoned the project. On September 11th, the various subcontractors of Melton's company said that they were pulling their machinery out of the job. (On or about September 11, 1976, Mr. Bryan together with a group of 15 people, flew to Hawaii for a two week vacation.)

On September 28, 1976, Bryan returned from Hawaii and between September 21st and October 8th, V.J.R.S. "audited the job" and found that there were $267,000.00 in unpaid debts.

Then, on October 14, 1976, V.J.R.S. through its attorney notified American Fidelity Fire Insurance Company of the alleged default of the principal.

On October 15, 1976, V.J.R.S. filed a suit in Los Angeles Superior Court, Case No. SWC 38323, in a matter known as V.J.R.S. Industries Inc., etc. vs. Rex Melton, et al. The copy of that Complaint and the Answer filed are attached hereto. The Ninth and Tenth Causes of Action are against American Fidelity Fire Insurance Company for recovery under the bond and for negligence. The alleged negligence is stated to be that American Fidelity had a duty to V.J.R.S. to ascertain whether or not Melton had a valid contractor's license and that because American Fidelity did not determine that Melton was not properly licensed V.J.R.S. suffered the damages set forth in their Complaint.

UNPAID SUPPLIERS:

Attached hereto is a schedule of 62 entities having claims against the project in an ascertained amount. The 62 claimants total $255,520.29. This list was compiled from a stack of audit letters sent by V.J.R.S. Industries on the letterhead of Continental Pacific Associates on September 24, 1976, the results of which were given to me at the meeting of October 20, 1976.

In addition to these claims I am aware of no less than $50,000 in additional claims and, in my estimation, the total amount of the unpaid suppliers on this project is probably in the area of $325,000.00 to #350,000.00.

Please note that the bond that we have written, by its specific terms, inures only to the benefit of the named obligees no cause of action is given to suppliers directly.

COMPLETION ESTIMATES:

In addition to the bid of 3-D Services (many of the particulars of which are questioned by John Elliott, my consultant), our offices has invited several contractors to bid on the completion of the project. This will be useful whether or not American Fidelity elects to complete the project in that we can comply with the strict letter of our bond by procuring a completion contractor to be used by V.J.R.S. Industries to use on its own. As of the writing of this letter 6 sets of plans have been picked up and no bids have been returned.

John Elliott's prime objection to the cost take-off done by 3-D Services, Inc. is that it does not probably account for some items which may have been part of Melton's contract and I have the impression that Mr. Elliott believes that the project would take approximately $150,000.00 to complete with no large allowance for contingencies. One very large unknown factor on the project is approximately 20,000 yards of excess material that has been jumped over a vertical slope on the south side of the project. My observation of the project shows me that this excess material has been deeply eroted and no swalls or ditches have been planned or provided to take care of run-off in this area. This soil is improperly compacted and could prevent a very costly problem in completing the project.

UNDERWRITING:

This bond was produced by Edgar Cruz of KAMAC in association with Bowker Insurance Company of Lomita. On October 21, 1976, I met with Don Bowker in his offices to discuss the underwriting. He told me that the first contract he had was from Jack Bryan who came to his offices and requested a bond for V.J.R.S. to the County as required by the Lease with V.J.R.S. as the owner/builder. This was probably in May of this year or possibly early June. Bowker discussed the matter with the underwriter at Safeco Insurance who declined to write because the financial statements of V.J.R.S. were not strong enough and Safeco was not inclined to write the bond as an owner/builder. Bowker wrote the liability policies on the park and these have not been cancelled for failure to pay premium.

The business was referred to Bowker by Joe Dismondi of the firm of Adams, Hambros and Dismondi, of Redondo Beach, because Dismondi could not place the bond. When Safeco could not write the bond Bowker turned it over to Edgar Cruz.

On October 22nd, I met with Edgar Cruz who told me that Bryan first asked him to acquire bond for V.J.R.S. as an owner/builder. Edgar said that he called Paul Walawski at Market Insurance Corporation and ran the idea by Paul. Edgar says that Paul responded that Market could not write an owner/builder bond and Cruz felt that was the end of his involvement.

Cruz was then contacted a few weeks later by Bryan who told him that the project was being done by a licensed contractor under writtencontract and Bryan wanted to acquire a bond for this contractor, Rex Melton. Cruz then submitted this to Market Insurance and the bond was written. You should note that the construction contract bears a date of April 1, 1976, and the bond was written on July 7, 1976. Terry Beals tells me that Cruz took a $1,200.00 fee above the premium for writing this business.

THE BANK:

On Friday, October 29, 1976, William Knell, CPA, and I went to Bakersfield to audit the bank's records to the extent that they would permit.

Mr. Knell's report is not yet prepared but will be forwarded to you upon receipt. Our additional investigation shows many examples of the bank paying bills twice, paying for machinery and items clearly not related to the construction project (for example: several thousand dollars of motel bills), and negligence on the part of the bank in paying reimbursement for payroll without any documentation whatsoever to support the voucher.

During conversations during that day with Clifford July, President of American National Mortgage Company, I inquired what the mortgage company's position would be in the event American Fidelity Fire Insurance Company declined to complete the project. July said that the mortgage company has an assignment of the lease between V.J.R.S. and the County and that, in event that the County defaults V.J.R.S. for failure to complete the project or for any other reason, the County would record its assignment and foreclose on the trust deed given under the building and loan agreement.

During a meeting with the County, I was told by Klaus Marks of the Real Estate Department of the County that Title Insurance Company wrote an ALTA policy guarantying that the bank's trust deed was a priority lien on the leasehold. This trust deed was recorded on April 30, 1976, and both Bryan and Melton have told me that actual construction began no less than a week before then. This means that, *if* these dates are correct, that the trust deed of the bank is junior to any and all valid mechanics' liens which may be recorded against the leasehold interest. (Since the ground itself is County property it is not subject to mechanics' liens. However, the code provides that the leasehold interest of V.J.R.S. Industries is subject to lien and sale).

## RECOMMENDATION

Based on the foregoing, I must reluctantly recommend that a large reserve be posted. We already have a demand from one of the obligees for the entire penal sum of the bond and while I feel the defenses are very meritorious as to this obligee, I am sure that we will have a demand from the other obligee, the County of Los Angeles. I am, frankly, fearful that our defenses against the County may not prevail due to the equities favoring the County's position. While both the bond and surety law permit us to impute a breach by one obligee to a co-obligee, I feel that the Court may try to circumvent this due to the County's lack of involvement in any of the apparent chicanery of V.J.R.S. Industries.

Very truly yours,

KENT LEEDS VALLETTE

KLV:jw

Attachments as noted

4
ATTACHMENT B.1

0900-96186-001-64

MAY 15 1980

GC:OL

DJ No.: 46-12C-1590

Gerald L. Elston, Esq.
Commercial Litigation Branch
Civil Division
Department of Justice
Washington, D. C. 20530

Re: V.J.R.S. Industries, Rex Edward Melton, Jr.
d/b/a Western Environmental Landscape
Systems, Inc.

Dear Mr. Elston:

Your letter of March 11, 1980, requesting information in the above-named matter has been referred to this office for response.

Background

V.J.R.S. Industries, Inc., was a construction company incorporated in the State of California in March 1971.

On March 25, 1976, V.J.R.S. entered into a twenty-five year lease agreement with the county of Los Angeles to construct a recreational vehicle campground and related facilities at Bonelli Regional Park. The agreement also required V.J.R.S. to obtain a surety bond for this project with V.J.R.S. as the principal and Los Angeles County as obligee.

In April of 1976 Jack Bryan, President of V.J.R.S., went to Donald Bowker, owner of Bowker Insurance Agency and asked him to obtain bonding for V.J.R.S. for the campground project. Mr. Bowker submitted the bond package to Safeco Insurance Company but it was declined primarily because Safeco would not write surety bonds for owner-builders.

In May 1976, Mr. Bowker called Mr. Edgar Cruz, an insurance agent who also specialized in the surety bond field. Mr. Cruz agreed to help V.J.R.S. obtain bonding. Mr. Cruz submitted the bond application to Mr. Paul Walaski of Market Insurance, a subsidiary of American Fidelity Fire Insurance Company (AFFI). Walaski told Cruz that Market would not even consider a bond for the V.J.R.S. project because Market and SBA would not approve bonds for builder-owners.

It should be noted that construction on the project began in April 1976, apparently at the direction of Jack Bryan, V.J.R.S. Also, that the attempts to secure bonding referred to above were all for bonds for V.J.R.S. as the primary contractor.

On May 26, 1976, a few weeks after AFFI had declined the V.J.R.S. bond application, Jack Bryan called Edgar Cruz again. He said that he had gotten a contractor for the campground project and wanted Cruz to help this contractor obtain bonding. Mr. Cruz met with Jack Bryan and Rex Melton, owner of Western Environmental Landscape Systems, Inc. (Western). One of the documents reviewed by Mr. Cruz at this meeting was the construction contract between V.J.R.S. and Western. This contract was dated April 1, 1976, notwithstanding the fact that Western was introduced as the contractor at this meeting in the latter part of May. No comment was made regarding this apparent postdating of the contract.

On May 26, 1976, Western applied to AFFI for a bond for this project. The request was referred to SBA and the Agency agreed to guarantee the bond on June 31, 1976. AFFI issued the bond on July 7, 1976, changing the obligee from the county of Los Angeles to V.J.R.S. SBA apparently had notice of this change and had no objections.

There are two primary questions for consideration in this matter. They are: (1) Whether the subcontract between V.J.R.S. and Western was a mere subterfuge to avoid the strict prohibition of SBA and AFFI to bond owner-builders; and (2) whether, if the above is true, this fraud would constitute a basis for action by the government under the False Claims Act.

The SBA's Surety Bond Guaranty Program is operated under certain standard procedures which are set forth in SOP 50 45, issued August 1, 1973. Paragraph 3(b) of that SOP specifically prohibits issuance of a guaranty for bonds to owner-builders. A copy of the relevant portions of that SOP is attached for reference.

The facts in the present case present a strong showing that the subcontract between V.J.R.S. and Western was a sham to avoid the SBA/AFFI prohibition of bonding builder-owners.

Although the subcontract was dated April 1, 1976, it is difficult to believe that the date is genuine for the following reason. Construction on the project began in April 1976. Throughout April and May of 1976, V.J.R.S. attempted to obtain bonding for itself as the primary contractor. Thus, V.J.R.S. must have been directing the construction on this project during this time period.

In fact, the preponderance of evidence points to the conclusion that Jack Bryan, V.J.R.S., was always in control of this entire project. Disbursement vouchers authorizing payment from funds for this project in an account at the American National Bank could only be signed by Jack Bryan and two other employees of V.J.R.S. He also, personally, controlled all funds to subcontractors, authorized all purchase orders and supervised all physical aspects of the construction. Key employees of V.J.R.S., when they were interviewed by SBA External Auditors, stated that they knew that Bryan was in charge of this project. A private investigator hired by the surety contacted various suppliers and subcontracts involved in this job. Out of 47 companies or individuals that he contacted only five knew who Rex Melton was. In general, he was referred to as the man handling the landscaping.

Other facts which tend to show that Rex Melton was only a front for V.J.R.S.'s control of this project are: (1) Melton was removed from his job two days after the surety bond was issued; (2) Bryan's employees were put on Western's payroll; (3) Bryan's company, Eastern Shore, operated the campground for the next 10 months; and (4) V.J.R.S. made the payment for the surety bond and application fees.

These facts show that Jack Bryan and V.J.R.S. exclusively controlled this project and operated as the general contractor. Thus it seems clear that the Western contract was merely a device to obtain the SBA guaranty and avoid the SBA prohibition of guaranty of bonds to owner-builders.

There is little doubt that if the above subcontract were merely a contrivance to induce SBA/AFFI to issue a surety bond such a scheme would constitute a fraudulent act. In turn such fraud would constitute a false claim within the scope of the False Claims Act.

SBA is authorized in Section 411(a) of the Small Business Investment Act of 1958 to "guarantee any surety against loss." Section 411(b) designates the agreement between SBA and the surety as a "contract of guarantee." This language has been interpreted generically to include all classes of contracts which have as a common characteristic the guaranteeing of loss.

Therefore, the holding in the case of U. S. v. Globe Remodeling Co., 196 F. Supp 652 (U.S.D.C., D. Vt. 1960), inter alia, is applicable:

> "A claim for payment under the Federal Housing Administration guaranty obligation induced by fraud is a false claim, within the scope of the False Claims Act, even if payment is made to a presumably innocent lending institution."

See also: U. S. v. Neifert-White Co., 247 F. Supp. 878 (U.S.D.C., D. Mont. 1965) and U. S. v. Goldberg, 258 F. Supp. 540 (U.S.D.C., D. Mass. 1966).

The general purpose of the False Claims Act, however, is to reimburse the government for losses it sustains through fraudulent acts or false claims. It has been held that the False Claims Act cannot be construed to cover situations where a guaranty has been induced by fraud but where no claim has been made thereunder and therefore the government has sustained no loss. See: U. S. v. Tieger, 234 F.2d 589 (U.S.C.A., 3rd Cir. 1956).

In the present case the surety company has refused to honor the claims of the subcontractors and has made no claim for any payments from the SBA under its guaranty. Based on the above cases, the government would seem to have no loss upon which to base a cause of action for reimbursement under the False Claims Act. The SBA has, however, paid out funds under its Guaranty Agreement. As of February 1980, SBA has reimbursed the surety in the amount of $96,675.68 for attorney fees in litigation involving claims of subcontractors.

The question then is whether the reimbursement for attorney fees paid out by the government under the Surety Bond Guarantee Agreement with AFFI constitutes a loss recoverable under the False Claims Act since the guaranty was induced by fraud.

The loss should be recoverable. The SBA agrees in its Surety Bond Guaranty to reimburse the surety for 90 percent of all "losses" it sustains under the surety bond, "including attorney fees." The SBA has paid out the amount of $96,675.68 under its guaranty obligation. The bond would not have been granted but for the fraud of V.J.R.S. Thus any loss payable under the bond agreement would be a loss occasioned under the False Claims Act. See: U. S. v. Hibbs, 568 F.2d 347 (3rd Cir. 1977) and U. S. v. Woodbury, 359 F.2d 370 (9th Cir. 1966).

As before stated, SBA has, as of February 1980, reimbursed the surety in the amount of $96,675.68 for attorney fees. The surety is presently suing the financing bank, therefore expenditure of monies for attorney fees is expected to continue. This case is presently in the discovery stage. (Mr. Stanley Haren is the attorney for the surety and can be reached at (213) 788-9420 for assistance and information).

It is therefore our recommendation that suit be initiated under the False Claims Act for losses sustained by the government under the Surety Bond Agreement with AFFI. V.J.R.S. itself, has been adjudicated bankrupt, so that no recovery could be had against this company. Therefore, suit should be brought against Jack Bryan who appears to be solvent. The evidence against Rex Melton is sufficient to warrant action against him for his part in this scheme. However, we have been told by San Francisco District Office personnel that Mr. Melton is insolvent and has been or is in a mental institution recovering from the extreme stress of this matter. Therefore, we recommend no action against Mr. Melton at this time. While there may be possible actions of conspiracy to commit fraud (31 U.S.C. § 231) available against Don Bowker and Edgar Cruz, it is our belief that further evidence is needed to prove such charges.

Pursuant to your request, relevant documents are attached to this report. The SBA file and original documents are located in the SBA Office of Special Guaranties, 1815 N. Lynn Street, Rosslyn, Virginia. Mr. Frank Moorhof has control of this file and can be reached at 235-2907 for assistance and further information.

If you require anything further from this office, please feel free to call Myrna B. Silen at 653-6629.

Sincerely,

Eric S. Benderson
Chief Counsel

Enclosures

GC:MBSilen:mfw
cc: Ms. Silen
Reading File
Litigation
Mr. Norton
Mr. Moorhof

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AREA CODE 213
TELEPHONE 464-4262

5

OUR REF: 99 AM 129

September 21, 1977

United Inspection Bureau, Inc.
3550 Wilshire Boulevard
Los Angeles, California 90010

Attention: Mr. Perry Lisker, Claims Manager

RE: AMERICAN FIDELITY FIRE INSURANCE COMPANY
Principal : Western Environmental Landscape Systems
Bond Number : 04-206-1338305

STATUS REPORT

Dear Perry:

The following is an updated status report and request for authority to make an offer of settlement.

THE BOND:

The bond is a $490,875.00 bond written on the California Private Works Contract bond form wherein only V.J.R.S. Industries and the County of Los Angeles are named as obligees. By specific term of the bond, claimants thereunder are restricted to the named obligees.

PROJECT STATUS:

The project for which the bond was issued is a construction of a recreational vehicle park on a small promontory overlooking Puddingstone Reservoir in the Pomona area of Los Angeles County. The park project envisioned one hundred eighty-nine parking spaces for recreational vehicles. The design of the park was conceived and constructed so that the roads upon which the recreational vehicles drove and parked were laid out in three loops in design similar to that of a clover leaf with the access road being where the stem on the clover leaf would be situated.

The park is being constructed on ground owned by the County of Los Angeles. The County gave the 25-year Lease to V.J.R.S. Industries, Inc. and the Lease requires that V.J.R.S. Industries construct the park at its own cost and maintain it under the conditions of the Lease for twenty-five years paying the County a Lease fee based upon occupancy and other considerations.

The bond written by American Fidelity Fire Insurance Company is for the principal Western Environmental Landscape Systems and purports to be a bond for Western Environmental as the prime contractor responsible for construction of the entire project. Our principal, Rex Melton doing business as Western Environmental Landscape Systems asserts that the contract was a sham and that he entered into the agreement at the request of Mr. Jack Bryan, the President of V.J.R.S. Industries only because Mr. Bryan represented to him that the contract was needed as a requirement of the American National Bank, the lender on the project.

Essentially, the project is physically incomplete. The two smaller clover leaf installations known as A and B Loop have been completed and have been in operation since July of last year. The third Loop, referred to as "C Loop" has only been rough graded and some of the underground electrical sewer and water installations have been put in place. However, this portion of the park is not in use and our estimate of the cost to complete suggests that it would cost between $200,000.00 and $400,000.00 to complete "C" Loop and correct the deficiencies that exist in the remainder of the park.

LITIGATION STATUS:

On October 15, 1976, V.J.R.S. Industries filed suit against American Fidelity Fire Insurance Company and Rex Melton, among others, in the Los Angeles Superior Court in Case No. SWC38232. Essentially, V.J.R.S. seeks the cost to complete the park (between $200,000 and $400,000) plus damages for the unpaid bills that exist on the project which V.J.R.S. Industries asserts are the responsibility - of Rex Melton. For reasons for which hereinafter become important these obligations should be classified as follows:

1. Obligations wherein the suppliers to the project have perfected their rights by Mechanic's Lien. Our review of the matter indicates that there are approximately $212,000 worth of unpaid bills on the project wherein the suppliers have perfected their rights under the California Mechanic's Lien sections of the Civil Code;

2. Obligations not secured by a Mechanic's Lien. Our cost analysis indicates that there are somewhere between $110,000 and $220,000 in unpaid bills on the project where the suppliers have not perfected their rights by a Mechanic's Lien.

While the bond is a dual obligee bond solely to the benefit of the County and V.J.R.S. Industries, nevertheless many of the suppliers who have chosen to name American Fidelity Fire Insurance Company in their actions and we are currently defending many such litigations. None of these claims, either secured or unsecured have been settled and American Fidelity has taken the firm position that it has no responsibility to these suppliers.

It should be noted at this point that approximately ninety-five percent of the suppliers to the project have no contractual privity with Mr. Melton and, indeed, a great majority of the suppliers have never even heard Mr. Melton's name prior to work stopping on the project at which time V.J.R.S. Industries sent a letter to all the unpaid suppliers and informed them that they should make claim upon Mr. Melton's bond.

Most of the claimants have written contracts or purchase orders signed by Jack Bryan in the name of either V.J.R.S. Industries, Inc. or Eastshore Development Company which is a "dba" of V.J.R.S. Industries. Our most solid defense is, of course, that these obligations are not the responsibility of Mr. Melton and hence not the responsibility of the bonding company. Within the last ninety days the County of Los Angeles has intervened in the lawsuit brought by V.J.R.S. Industries and has asserted its own Complaint against American Fidelity on the bond. At the present time they are only seeking approximately $7,000.00 for unpaid rent which is a quentionable claim. However, the County will certainly claim for the cost to complete the project at some point unless another method can be found to complete the project.

## V.J.R.S. CHAPTER II PROCEEDINGS:

In May of 1977 V.J.R.S. Industries filed a Petition for Bankruptcy under Chapter 11 of the Bankruptcy Act in the United States District Court in Los Angeles. That case has been given Case No. 04-7331-JD. V.J.R.S. filed this proceeding essentially to forestall the foreclosure proceedings with which it was threatened by American National Bank, the lender on the project in that V.J.R.S. Industries was in default on its loan. V.J.R.S. borrowed $600,000.00 from American National Bank of Bakersfield and the loan is handled by its subsidiary American National Mortgage Company also of Bakersfield. Under the loan agreement the bank was to disburse the construction fund under a voucher system and was to pay itself interest out of the loan proceeds. By the end of August, 1976, all of the loan proceeds had been dissipated and there was found to be insufficient funds to complete the project.

In the bankruptcy proceedings, V.J.R.S. Industreis proposed that the park be sold to a bidder at a minimum bid of $1,000,000 which, it was alleged, it would raise sufficient capital to pay all of the debts on the project, pay off the Deed of Trust and Note held by American National Bank in the amount of $600,000.00 and put some money in the possession of V.J.R.S. No buyer has been located that will assume the park under these terms.

## SETTLEMENT PROPOSAL:

There is a potential buyer for the park by the name of Don Pasley doing business as Pasley Electric. Pasley proposes, essentially, to put up $750,000.00 to buy the park by which it will assume the obligation to pay off American National Bank (whose indebtedness at this point is claimed to be in the amount of $693,000.00 with the accrual of interest, costs, and attorneys fees. The remaining $57,000.00 could be applied to outstanding obligations on the park and Pasley agrees to complete the park with its own funds above and beyond the $750,000.00. Pasley would supply its own bonds from its own surety to guaranty to the County that the work would be completed and our bonds would be exonerated.

The Deed of Trust in favor of American National Bank was recorded on April 30, 1976 and Title Insurance and Trust Company guaranteed by a title policy to American National Bank that its Deed of Trust would be a first Deed of Trust and would enjoy first priority security on the project. However, by California law, if physical work of even an insubstantial nature has commenced on the project prior to the date upon which the Deed of Trust for the construction loan is recorded, then all Mechanic's Liens that may be filed during the course of the project enjoy a priority over that Deed of Trust in the event the Mechanic's Liens are foreclosed upon. While the initial appraisal reports on the project indicated that the park, when completed, would be worth more than $1,000,000, there is substantial evidence that the park in its current state of partial completion is worth less than $600,000.00. Therefore, if the bank forecloses upon its Deed of Trust and sells the property, there will not be enough funds realized by the foreclosure sale to pay off Mechanic's Lien holders ($212,000.00) plus the bank's obligation and Title Insurance and Trust Company would be forced to pay the first lien holders to protect American National Bank. With this exposure in mind, Title Insurance and Trust Company has tentatively agreed to contribute $125,000.00 to effectuate a release of its obligations to American National Bank.

Essentially, and by way of partial summation, the receiver in bankruptcy proposes that if a sufficient fund of money can be raised to make a substantial offer to the creditors, then all of the obligations on the project can be obsolved and Pasley can be permitted to purchase the park under the terms set forth hereinabove. The County has tentatively agreed to accept Pasley under the Lease and to release its claim against the bond.

SETTLEMENT RECOMMENDATION:

While we possess substantial defenses to the claims of V.J.R.S. Industries, Inc. I would nevertheless recommend to you that you authorize a contribution of $25,000.00 to settle this case. We stand currently exposed for the full penal sum of the bond in the lawsuit instituted by V.J.R.S. Industries. Even if our defenses prevail against V.J.R.S. Industries, (and I am very confident that they would) we would still stand exposed to the County of Los Angeles for the cost to complete the project and, frankly, our defenses as to the County are not substantial. In addition, my request for authority is, in my estimation, for less than one-half of the anticipated cost to complete the defense of the lawsuit instituted by V.J.R.S. Industries, Inc. In addition, I would like you to consider the possibility that in the event $25,000.00 should prove insufficient, that I be given an additional $10,000.00 worth of authority if necessary.

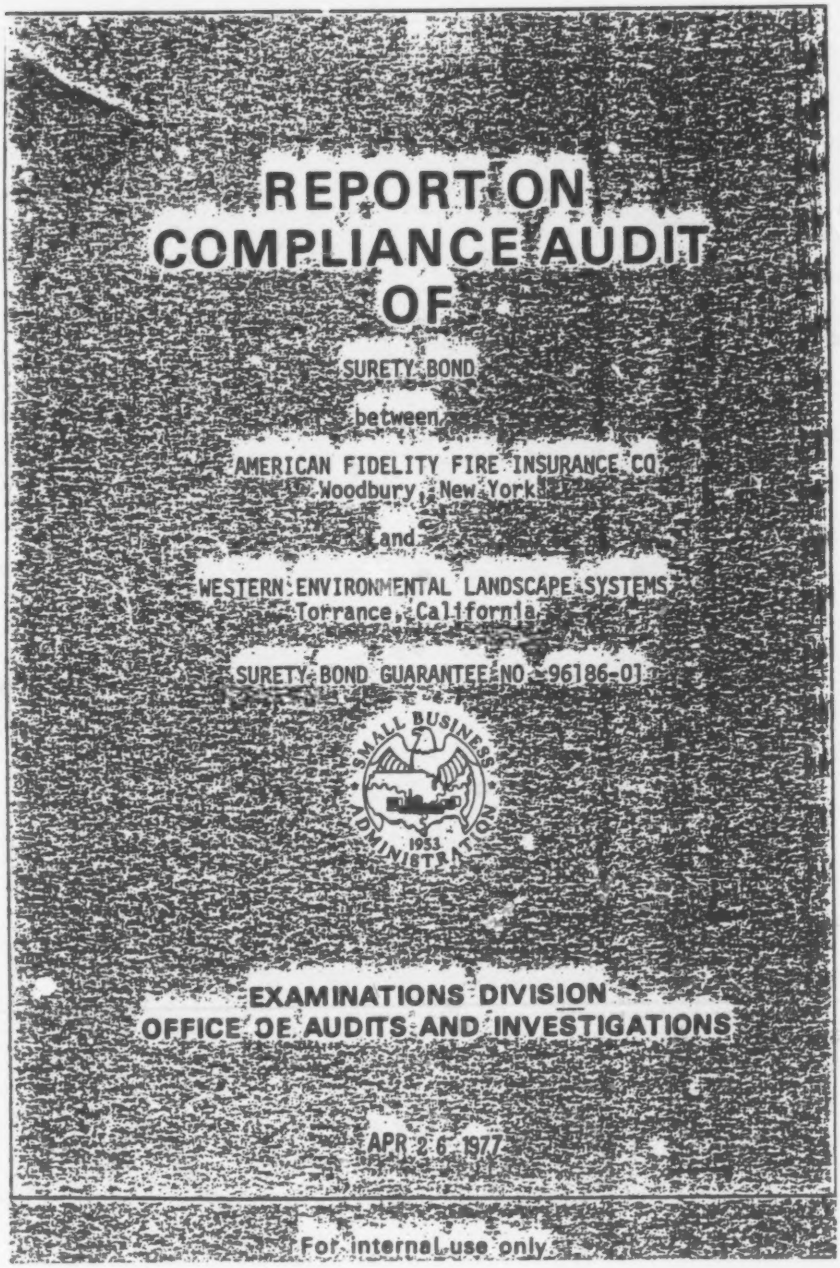
It is imperative that I have a decision on this as soon as possible. A meeting has been scheduled for the morning of September 23, 1977 by all concerned parties and I would like to have my authority by that time.

Let me stress that the proposed settlement of the entire dispute calls for V.J.R.S. Industries to receive no additional cash or other compensation and all of the funds being put up by the various parties would go to the suppliers of labor and material on the project that have unpaid bills. Under the circumstances of this case where there are strong overtones of fraud by the obligee V.J.R.S. Industries, I would not recommend settlement at all _if_ V.J.R.S. Industries were to profit by the settlement.

Very truly yours,

KENT LEEDS VALLETTE

KLV:jw



# REPORT ON COMPLIANCE AUDIT OF

SURETY BOND

between

AMERICAN FIDELITY FIRE INSURANCE CO
Woodbury, New York

and

WESTERN ENVIRONMENTAL LANDSCAPE SYSTEMS
Torrance, California

SURETY BOND GUARANTEE NO. 96186-01

SMALL BUSINESS ADMINISTRATION
1953

EXAMINATIONS DIVISION
OFFICE OF AUDITS AND INVESTIGATIONS

APR 26 1977

For internal use only

This compliance audit was made in accordance with established policies and procedures. This report is issued by the Examinations Division, Office of Audits and Investigations.

APPROVED:

R.V.

R. V. Shaw, Director
Examinations Division

APR 26 197

DATE

## AUDIT SUMMARY

Findings disclosed by this audit are summarized as follows:

- The contractor's eligibility for bond guarantee was questionable. The bond was originally denied to VJRS Industries, Inc., the obligee and builder-owner and there was a question as to the the relationship between Western Environmental Landscape Systems and VJRS Industries, Inc.

- American Fidelity Fire Insurance Co. failed to document the circumstances which justified a bond guarantee under the Surety Bond Guarantee Program.

- The contractor did not obtain bonding until ninety-eight days after the contract was signed.

- The underwriter that produced this bond for American Fidelity Fire Insurance Company may have taken $1,200 in excess of the maximum allowable premium.

- The surety's underwriting review appears to be inadequate based on the review of the underwriting file.

This review was terminated before completion due to unusual circumstances which arose as described in the Results of Audit.

## INTRODUCTION AND BACKGROUND

The Surety, American Fidelity Fire Insurance Co. (AFF) wrote Bond No. 04-206-1338305 with Western Environmental Landscape Systems (Western) of Torrance, California, the principal. The bond was a performance and payment bond issued through Market Insurance Corporation of Los Angeles, California. The contract was for land improvement and the development of a recreational vehicle park. The application for surety bond guarantee and Guarantee Agreement, SBA Form 990, named Los Angeles County as obligee. The AFF bond named VJRS Industries, Inc. (VJRS) as obligee and a rider to the bond named VJRS and the County of Los Angeles as dual obligees. The amount of the contract was $490,785 and the bond was for 100% of the contract price with a 90 percent surety bond guarantee. The term of the bond was July 7, 1976 through July 7, 1977.

Western defaulted on completion of this contract and had a number of claims against it from suppliers in excess of $300,000. The default was brought on by a difference of opinion between VJRS and Western as to VJRS's progress payments to Western and the liability for the amounts owed to the suppliers.

AFF is fighting payment on this bond for the following reasons:

1. AFF claims that Mr. Melton, president of Western, might have actually been an employee of VJRS and only formed Western to aid VJRS in getting bonding (VJRS was previously refused bonding).
2. AFF claims that there is good reason to believe that both Western and VJRS committed fraud in connection with both the contracting and the bonding.

3. The current claims against the bond are being made by subcontractors who contracted with VJRS and not Western. AFF feels that they would not be liable under the bond in these cases.

The current status is that AFF's attorneys, Barry Bernstein and Kent Vallette, are going through discovery attempts and taking a deposition from VJRS president, Jack Bryan. When the facts are all in, they will move to dismiss the surety's liability. The expenses by the surety to date are limited to the $14,359 paid to the law offices of Barry Bernstein.

Western Environmental Landscape Systems (Western)

Western was a sole proprietorship owned and operated by Mr. Rex E. Melton, Jr. The contractor is located at 1814 W. 242nd Street, Torrance, California.

For the four months ended April 30, 1976, Western had sales of $52,807 and a net profit of $15,346. For the same period, the balance sheet disclosed total assets of $248,584, total liabilities of $37,695 and a net worth of $210,889.

American Fidelity Fire Insurance Co. (AFF)

AFF is a subsidiary of the American Plan Corporation with its main offices located at Woodbury, New York. AFF is engaged in writing surety bonds for a considerable number of building contractors. AFF is licensed to transact surety business in all states and other areas except: Alaska, Canal Zone, Colorado, Guam, Hawaii, Kansas, Missouri, Nebraska, New Hampshire, and the Virgin Islands.

AFF shares their office premises with the American Plan Corporation (APC), their parent corporation. The daily operation for surety bond underwriting is the responsibility of Richard Sumner, one of APC's vice presidents. The daily operation for claim activity arising from the bonds is the responsibility of Mario Cacace, another vice president of APC.

AFF is listed in Department of the Treasury Circular 570; 1976 Revision, as a surety company acceptable on federal bonds with an underwriting limitation of $552,000.

Since the Surety Bond Guarantee (SBG) Program's inception, AFF has been an active participant. As of November 30, 1976, the SBA has guaranteed 14,592 bonds written by AFF for approximately $923 million and the SBG Program has reimbursed AFF about $10.8 million for losses incurred in 608 surety bond guarantees.

Underwriting of surety bonds by AFF is done by Market Insurance Corporation (Market) of 3550 Wilshire Boulevard, Los Angeles, California under a managing general agent contract. Market has general agents located throughout the country who are under contract to do the individual underwriting.

Market has contracted with United Inspection Bureau (UIB) of 3550 Wilshire Boulevard, Los Angeles, California, for all claims processing activities which may occur in the event of a breach or default on any bond. Whenever a general agent is notified of an impending breach or default he is required to immediately notify UIB. UIB would then notify the Small Business Administration of the problem. UIB is responsible for securing local surety attorneys to represent AFF in resolving the problem in the most efficient manner.

## SCOPE

The scope of the audit was originally intended to be a review of the surety's claims file, bond file, and underwriting file in order to determine the compliance of the surety's records with the laws, regulations, and operating procedures of the Surety Bond Guarantee Program.

This review was terminated before completion due to unusual circumstances which arose as described in the Result of Audit.

## RESULTS OF AUDIT

Based upon our review, we believe that the surety has not complied with the applicable laws, regulations, terms and conditions of the Surety Bond Guarantee Program as stated in the following audit findings.

### Questionable Eligibility - Relationship of Parties

The contractor's eligibility for bond guarantee was questionable. The bond was originally denied to VJRS Industries, Inc. (VJRS), the obligee and builder-owner and there was a question as to the relationship between Western Environmental Landscape Systems (Western) and VJRS.

SBA Standard Operating Procedures, Section 50 No. 45 forbids bonding of builder-owners. On March 25, 1976, the County of Los Angeles contracted VJRS to take possession of the park area and construct the recreation vehicle park as an owner-builder. VJRS attempted to obtain bonding from both Market and Safeco Insurance Company but was denied due to the company's weak financial statements and the fact that VJRS was an owner-builder. VJRS then came to the same underwriter and attempted to get bonding for Western, who was going to do the job for VJRS as a subcontractor. The bond was written for Western on July 7, 1976. The underwriting review for the bond was based on the personal financial statements of Mr. Rex Melton.

Mr. Melton started the job on approximately April 15, 1976, under the direction of Mr. Jack Bryan, president of VJRS. Mr. Melton signed none of the contracts and did not issue purchase orders. Contracts with suppliers and subcontractors were made in the name of VJRS. Mr. Melton testified to the surety's attorney that he was originally hired to supervise the project for VJRS. In July of 1976, Mr. Melton and Mr. Bryan had a disagreement as how to proceed with the project. Mr. Melton refused to follow Mr. Bryan's direction and on July 9, 1976, was thrown off of the job. In testimony to the surety's attorney, Mr. Bryan disagreed with the above facts, but admitted that he put himself and a number of his own employees on Western's payroll to assist in completing the job.

Under the Surety Bond Guarantee Program Standard Operating Procedures, Section 50 No. 45 and memorandums and letters distributed to the sureties, bonding of an owner-builder is prohibited. VJRS's bonding attempts were refused for this reason. With the facts presented in this case, it is questionable whether Western was a bona fide subcontractor or whether VJRS used the Western format to circumvent the owner-builder requirement and obtain bonding.

Mr. Stanley Haren, an attorney within UIB stated that AFF is fighting payment on the bond for the following reasons:

- Mr. Melton was possibly an employee of the VJRS and formed Western for bonding purposes only.
- UIB has good reason to believe that Western and VJRS committed fraud in connection with both the contracting and bonding.
- The current claims against the bond are being made by subcontractors who contracted with VJRS and not Western.

No comment was solicited from AFF due to the unusual circumstances of this case.

### Questionable Eligibility -- Justification for Surety Bond Guarantee

AFF failed to document the circumstances which justified a bond guarantee under the Surety Bond Guarantee Program.

SBA Regulations Part 115.4(d) requires that the applicant must represent that a bond was not obtainable on reasonable terms and conditions without SBA's bond guarantee assistance. SBA Regulations, Part 115.6(b) requires surety to affirm that without the SBA guarantee to surety it would not issue any of said bonds to principal. The Surety affirmed that a bond was not otherwise obtainable, but did not document the circumstances in the underwriting file.

Mr. Terry Beals, chief underwriter, of Market stated that AFF did not have the facility to bond over $50,000 by non-SBA guaranteed means. He claimed that any bond over $50,000 written would be SBA guaranteed.

## Timing of Bonding Questionable

The contractor did not obtain bonding until 98 days after the contract was signed.

Paragraph two of the Guarantee Agreement, SBA Form 990, states that the bond will be executed "Surety represents that such bond or bonds when executed by it as to terms and conditions will be in accord with those executed by professional sureties . . ."

The contract, which was signed on April 1, 1976, requires that the contractor furnish the owner payment and performance bonds before commencing work. Work on this contract was begun on or around April 15, 1976, according to Mr. Melton. The bond was applied for by Western on May 26, 1976, and was not issued by AFF until July 7, 1976.

A professional surety performing adequate underwriting tests would not have written a bond on a contract that had been in process for 98 days and was already experiencing trouble.

No comment was solicited from AFF due to the unusual circumstances of this case.

## Excess Premium Charge

The underwriter that produced this bond for American Fidelity Fire Insurance Company may have taken $1,200 in excess of the maximum allowable premium.

The maximum premium allowable under the Surety Bond Guarantee Program is 1 1/2 percent of the first $250,000 and one percent of any amount of the contract price over $250,000 as defined in Part 115.7(e) of the regulations. The premium charged on this bond was the maximum allowable of $6,158. In the event that Mr. Cruz did receive an additional amount, the total would have exceeded the maximum allowable and would not have complied with the regulations.

The bond was written by Mr. Edgar Cruz through Bowker Insurance Agency (Bowker) of Los Angeles, California. VJRS had been attempting to bond this contract since the job began in April of 1976. Bowker originally tried to obtain bonding through Safeco Insurance Company, but was denied. Mr. Cruz then approached Market for VJRS and was again refused bonding. He reapproached Market in an attempt to bond the same contract through Western and received approval on July 7, 1976. In a status letter to UIB from its claims attorney, the attorney stated that Mr. Terry Beals of Market had told him that Mr. Cruz received $1,200 in excess of the premium for writing this bond.

No comment was solicited from AFF due to the unusual circumstances of this case.

Inadequate Underwriting Review

The surety's underwriting review was inadequate based on the review of the underwriting file.

AFF has not complied with paragraph 2 of the Guarantee Agreement, SBA Form 990 which states "Surety represents that such bond or bonds when executed by it as to terms and conditions will be in accord with those executed by professional sureties . . ."

The following underwriting review procedures which are normally utilized by professional sureties in making underwriting decisions were not utilized by AFF when they made their underwriting decision for Western.

- The SBA Form 912, Question 7 "Have you ever been charged with or arrested for any criminal offense other than a minor motor vehicle violation?" is answered yes but there are no details furnished as required.
- Analysis of financial statements.
- Evaluation of job cost by surety.
- Review of the contractor's managerial or technical skill.
- Copies of tax returns.
- Financial statement is in conflict with the underwriting review. The networth per the April 30, 1976 balance sheet does not agree with the SBA Form 994B. The underwriting file did not contain any explanation of why the figures differed.

No comment was solicited from AFF due to the unusual circumstances of this case.

## FACT SHEET

| | | | |
|---|---|---|---|
| Principal: | Spight Landscape Contractors<br>New Orleans, Louisiana | | |
| Obligees: | City of New Orleans<br>Louisiana Highway Department | Bond No: | 600-68344-014-58<br>600-68344-020-51<br>600-68344-021-53 |
| Surety: | American Fidelity Fire Insurance<br>Woodbury, New York | | |
| Underwriter: | Market Insurance Corporation<br>Encino, California | | |
| Claims Adjuster: | United Inspection Bureau<br>Encino, California | | |
| Cost of Original Contract: | $317,000 | | |
| Loss to SBA: | $28,193 | | |

## BACKGROUND

Spight Landscape Contractors received an SBA guaranteed bond in 1976, which it defaulted on in 1977. SBA will not bond contractors with a default record, but will reinstate the contractor in the Surety Bond Guarantee Program, if the contractor repays claim costs. Sidney Spight, the principal, pledged property as collateral in order to repay the loss under this bond, and was subsequently readmitted to the SBA Program. When Spight was declared in default on two more bonds received in 1978, the surety discovered that he did not own the collateral pledged to the surety and SBA. The claims adjuster for the surety failed to confirm the ownership of the collateral prior to executing the repayment agreement with Mr. Spight.

In June 1976, SBA authorized a guarantee on a bond executed by AFF for Spight Landscape Contractors. This contract was for the planting and maintenance of trees in a park owned by the City of New Orleans. Spight completed the actual planting on this job; however, the company failed to maintain the trees for one year as required by the contract, and the city was forced to replace them. In August 1977, the obligee declared Spight in default on this project.

If a contractor is declared in default on an SBA guaranteed bond, SBA policy prohibits the award of additional guarantees until the contractor has repaid SBA and the surety for their loss. (Prior to the default on this project, Spight had been approved for two bid bonds on contracts for the Louisiana Highway Department.) Therefore, the surety's claims adjuster verbally established a repayment agreement with Spight and recommended that SBA reinstate Spight to the program. In December 1977, under the repayment agreement, Sidney Spight, the owner of Spight Landscape Contractors, pledged as collateral certain property he owned in the New Orleans area.

SBA accepted UIB's recommendation and guaranteed bonds for Spight Landscape on the two Louisiana Highway Department contracts in January 1978. For some unknown reason, the repayment agreement was not formally executed until September 1978 -- nine months later. Meanwhile, in April of that year, the property pledged as collateral by Spight had been reposessed by a creditor. Spight Landscape was decalred in default on the two highway projects in August 1980.

Under the terms of the repayment agreement executed in regard to the original bond, UIB attempted to foreclose on the collateral pledged by Sidney Spight. However, it was only then determined that Spight did not own the real estate pledged as collateral at the time he entered into a repayment agreement with the surety. At the time Spight pledged this collateral, in September 1978, the surety's claims adjuster failed to confirm his ownership of the property. The surety anticipates the loss under the two Highway Departments to total in excess of $67,000. However, claims paid to date have totaled only approximately $6,000. To date, the surety has been unable to recover any portion of its and SBA's loss on these three bonds.

SMALL BUSINESS ADMINISTRATION

APPLICATION FOR SURETY BOND GUARANTEE ASSISTANCE

NAME OF APPLICANT AND ITS PRINCIPAL
Spight Landscape Contractors, Inc.

APPLICANT'S HOME ADDRESS (include ZIP)
10001 Old Gentilly Road
New Orleans, La. 70127

APPLICANT'S BUSINESS ADDRESS (include ZIP)

NAME OF BROKER/AGENT
A J Pilet Ins Agcy
Surety & Special Market Underwriters, Inc.
6027 Chef Menteur Hwy, New Orleans, La. 70126

BROKER/AGENT'S ADDRESS (include ZIP)

BROKER/AGENT'S TELEPHONE (include Area Code)
(504-245-0453)

NAME OF SURETY IF KNOWN
American Fidelity Fire Ins. Co.

1. Applicant hereby states and affirms the following:

a. The gross annual receipts of my business (including affiliates) during the past fiscal year was $ 122,817. 99, or as annually averaged over the past 3 fiscal years (to the nearest hundreds) was $ ______.

b. A bid, payment or performance bond is required on the following project or to serve as a primary contractor or subcontractor thereon.

c. Contractor certifies having attempted (and failed) to obtain the required bonds without the SBA's guarantee; furthermore, the contractor certifies being aware that some sureties charge higher premium rates for bonds than others do.

d. Brief description of project including projected job completion date or, on prequalification, size of job and total work in progress you feel you can handle.

Prop. F-4510, perimeter planting, Louis Armstrong Park, for the City of New Orleans, La. Est. Complete: 90 Calendar Days

e. Approximate value of contract: $ 45,000.-0 (5% Bid Bond Required)

f. Applicant, in consideration of assistance from the SBA herewith agrees that it will comply with the nondiscrimination requirements of Title 13, Code of Federal Regulations, Part 112 and Part 113.

2. The date, time and place of the bid opening is as follows: (if applicable):

| | | |
|---|---|---|
| Date<br>5/11/76 | Time | Place<br>New Orleans, La. |

3. I have read the "Contractor's Fee" section (reverse side) and agree to abide by this fee schedule, PROVIDED I receive the contract sought and SBA extends its bond guarantee. I also agree to pay the contractor's guarantee fee to my Agent/Broker at the time I receive the bond, in accordance with Paragraph 9, reverse side.

4. I presently ☒ do not have an SBA Loan ☐ previous loan or other program assistance
☐ do have an SBA Loan through the ______ office
with a balance of $ ______ as of (date) ______

5. I ☐ am ☒ am not an SBA 8(a) Qualified Contractor

This bond application ☐ does ☒ does not pertain to an 8(a) contract ☐ does ☒ does not pertain to SBG Bond Line of Credit

☒ have received previous SBA bond guarantee(s) ☐ have not received previous SBA bond guarantee(s)

If you have received previous SBA bond guarantee(s), have you ever defaulted on any of them? (Either under this contracting concern's trade name or any other concern's of which you have been a principal ☐ Yes ☒ No

If "yes", detailed particulars are to be attached to all four(4) copies of this application form. Particulars should include at least the following: (1) Name of Surety; (2) Name of Obligee; (3) SBG #w/Suffix Number; (4) Value of Contract; (5) Date of Default; (6) Status of Default/ Claim, i.e., amount of loss to Surety, etc.; (7) Contractor's narrative explanation as to reason for default and actions taken to meet the obligations to the Surety under terms of the bond(s).

6. Applicant hereby authorizes any agent, broker or surety company in possession of credit, financial or work experience information concerning the undersigned applicant and the applicant's business to release the same to SBA, in order that SBA may evaluate the same for the purpose of bond guarantee assistance.

Applicant certifies that any information he submits to any agent, broker or surety company for their evaluation as to the bondability of this contracter is correct and accurate to the best of the contractor's knowledge.

7. Any intentionally false statement in this application or willful misrepresentation relative thereto is a violation of federal law, which may subject you to criminal and civil prosecution, 18 U.S.C. Sections 287,371,1001, 15 U.S.C. Sections 645, 31 U.S.C. Section 231, carrying fines up to $10,000 and imprisonment up to five years."

I hereby certify that all information presented herein is complete and accurate to the best of my knowledge.

| | |
|---|---|
| SIGNATURE (Applicant)<br>Sidney Spight | Executed this date<br>6-1-76 |

SMALL BUSINESS ADMINISTRATION

## SURETY BOND GUARANTEE UNDERWRITING REVIEW

SURETY COMPANY: American Fidelity Fire Ins Co

PRINCIPAL NAME: Smith Landscape Contrs., Inc.

SBA NO.: 68344-14

APPLICANT'S TRADE NAME AND ADDRESS:
[illegible] Landscape Contractors, Inc.
[illegible] Gentilly Road
New Orleans, La. 70127

Items 1-16 are to be completed on each bond Guarantee Submission to SBA including the initial Submission and All Subsequent Submissions

**A. SURETY'S REVIEW**

1. JOB DESCRIPTION AND LOCATION (Including Obligee): [illegible] eter planting, Louis Armstrong Park, for the City of New Orleans, La.

2. CONTRACT AMOUNT (Approx or Bid, Exact on Performance): $45,000.00

3(a) BOND $ OR %: 5%

3(b) PENALTY CLAUSE: ☒ YES ☐ NO

4. BOND NUMBER:

5. IS PRESENT PROJECT SIMILAR TO PREVIOUS WORK PERFORMED? ☐ YES ☐ NO

6. WHEN DOES JOB BEGIN?

7. SCHEDULED COMPLETION DATE: 90 Calendar Days

8. HOW MUCH AND STATUS OF WORK IN PROGRESS? NONE AT PRESENT

8(a) VERIFIED BY OBLIGEE(S): ☐ YES ☒ NO

8(b) HOW MANY?

8(c) OF HOW MANY?

8(d) HAS SURETY CHECKED WITH SUPPLIERS? ☐ YES ☒ NO

8(e) HOW MANY?

8(f) OF HOW MANY?

9(a) DATE OF FINANCIAL STATEMENT: 5/31/75 FY END

9(b) IS THERE SUFFICIENT WORKING CAPITAL? ☒ YES ☐ NO

10(a) FINAL (PAYMENT/PERFORMANCE) BOND BID? ☐ YES ☒ NO

10(b) WHAT IS BID SPREAD? To Be Rebid

NOTE: If this review is for a bid bond request, the Surety must forward SBA a listing of the Bid Spread prior to Surety's issuance of the final bonds.

11(a) SUBCONTRACTORS INVOLVED IN THIS JOB? ☐ YES ☒ NO

11(b) PARTICIPATION %

11(c) BONDED? ☐ YES ☐ NO

12. IS CONTRACT SBA 8(a)? ☐ YES ☒ NO

13(a) DOES CONTRACTOR REQUIRE FINANCIAL/MANAGEMENT/TECH ASSISTANCE? ☐ YES ☐ NO

13(b) IF YES WHAT TYPE?

14. REMARKS/CONCLUSIONS: Recommend approval.

15. CONTINUATION SHEET ATTACHED — CHECK (✓):

16. SBA FORM 990 (Guarantee Agreement) ATTACHED — CHECK (✓):

Items 17-35 are to be completed only on the initial submission and its Annual Up-Date

17. TYPE AND AMOUNT OF CONTRACTUAL WORK THIS CONTRACTOR HAS DONE PREVIOUSLY

18(a) LARGEST PREVIOUS CONTRACT: $

18(b) LARGEST PREVIOUS WORK PROGRAM: $

19(a) ANY DISPUTES? ☐ YES ☐ NO

19(b) ON SCHEDULE? ☐ YES ☐ NO

20(a) HAS CONTRACTOR EVER FAILED TO COMPLETE JOB? ☐ YES ☐ NO

20(b) DETAILS

21. WHAT IS EXPERIENCE(S) OF OFFICERS AND/OR OWNERS?

22(a) CONTRACTOR HAVE ADEQUATE EQUIP? ☐ YES ☐ NO

22(b) OWNED? ☐ YES ☐ NO

22(c) LEASED? ☐ YES ☐ NO

23. CONTRACTOR'S TAXES CURRENT? ☐ YES ☐ NO

24. CONTRACTOR INSURANCE COVERAGE SUFFICIENT? ☐ YES ☐ NO

25(a) SURETY RECEIVED COPY OF CURRENT FINANCIAL STATEMENT? ☐ YES ☐ NO

25(b) DATE OF FINANCIAL STATEMENT

25(c) PREPARED BY WHOM?

25(d) FINANCIAL STATEMENT SHOW DISCLAIMER? ☐ YES ☐ NO

25(e) TYPE OF FINANCIAL STATEMENT: ☐ CASH ☐ SIMPLE ACCRUAL ☐ COMPLETED CONTRACT ☐ % COMPLETION

25(f) NET WORTH: $

25(g) WCA

26(a) SURETY VERIFIED BANK BALANCE? ☐ YES ☐ NO

26(b) AVG BANK BALANCE: $

SBA Form 994B (2-73) REF SOP 50 45 PREVIOUS EDITIONS ARE OBSOLETE

| | | |
|---|---|---|
| 27(a) CONTRACTOR HAVE BANK LINE OF CREDIT?<br>☐ YES ☐ NO | 27(b) WITH WHOM? | 27(c) HOW MUCH BANK LINE OF CREDIT? |

| | | | |
|---|---|---|---|
| 28(a) VERIFICATION OF PAYABLES?<br>☐ YES ☐ NO | 28(b) AGED? (% over 60 days) | 28(c) HOW MANY? | 28(d) OF HOW MANY? |
| 29(a) VERIFICATION OF RECEIVABLES?<br>☐ YES ☐ NO | 29(b) AGED? (% over 60 days) | 29(c) HOW MANY? | 29(d) OF HOW MANY? |

30. ANY REMARKS FROM CREDITORS CONCERNING THIS CONTRACTOR

| | | | |
|---|---|---|---|
| 31(a) CONTRACTOR HAVE CURRENT SBA LOAN?<br>☐ YES ☐ NO | 31(b) HOW MUCH & STATUS? | 32(a) PREVIOUS SBA LOAN?<br>☐ YES ☐ NO | 32(b) SBA LOAN APPLIC. PENDING?<br>☐ YES ☐ NO |

| | | |
|---|---|---|
| 33(a) CONTRACTOR PREVIOUSLY BONDED?<br>☐ YES ☐ NO | 33(b) AMOUNT<br>$ | 33(c) WITH WHOM? |

| | | | |
|---|---|---|---|
| 34(a) CONTRACTOR HAVE BONDING LINE?<br>☐ YES ☐ NO | 34(b) AMOUNT<br>$ | 35(a) PREVIOUS SBA BOND GUAR.?<br>☐ YES ☐ NO | 35(b) AMOUNT & STATUS |

In our opinion, the principal appears to have the financial/management/technical abilities necessary to successfully complete this contract, however, we feel this contractor falls below the normal underwriting standards of our company, and we cannot issue bonds to this contractor without the SBA Guarantee.

| | |
|---|---|
| UNDERWRITER<br>Bruce G. Robillard<br>Surety & Special Market Underwriters, Inc. | DATE<br>6/1/76 |
| ADDRESS (Include Zip Code)<br>6827 Chef Menteur Highway<br>New Orleans, La. 70126 | TELEPHONE (Include A/C)<br>[illegible] |

**B. SMALL BUSINESS ADMINISTRATION'S REVIEW**

| | | | |
|---|---|---|---|
| 1. SBG NO. (With Suffix)<br>68344-14 | 2(a) REVIEW OF INITIAL BOND?<br>☐ YES ☒ NO | 2(b) SUBSEQUENT BOND?<br>☐ YES ☐ NO | 3. MEETS SIZE STANDARDS?<br>☐ YES ☐ NO |
| 4(a) CONTRACTOR NEEDS FINANC/TECH ASSIST.?<br>☐ YES ☐ NO | 4(b) WHAT TYPE? | 5(a) REQUEST OTHER SBA ASSIST MAD ETC.?<br>☐ YES ☐ NO | 5(b) WHAT TYPE? |

6. IF NECESSARY ASSISTANCE IS NOT READILY AVAILABLE IN GOVERNMENT, HAVE YOU REFERRED APPLICANT TO FUNDED ASSISTANCE PROGRAMS I.E., MINORITY CONTRACTORS ASSISTANCE PROGRAM (MCAP) ETC.?

(NAME ASSISTANCE)

| | |
|---|---|
| 7(a) BASED ON THE ABOVE<br>THERE ☐ IS ☐ IS NOT REASON TO EXPECT SUCCESSFUL COMPLETION OF THE CONTRACT | 7(b) THE COSTS<br>☐ DO ☐ DO NOT APPEAR TO BE REASONABLE |

7(c) IT HAS BEEN DETERMINED THAT THE REQUESTED BOND(S)<br>☐ IS ☐ ARE NECESSARY AND THE SURETY COMPANY HAS INDICATED THAT IT WILL NOT ISSUE THE BOND(S) WITHOUT THE SBA GUARANTEE

8. REMARKS/CONCLUSIONS

9. ATTACHMENTS (Check Appropriate Box)

| | | | |
|---|---|---|---|
| 9(a) CONTINUATION SHEET ☐ | 9(b) SBA FORM 990 ☐ | 9(c) CONTRACTORS CURRENT FINANCIAL STATEMENT ☐ | 9(d) COPIES OF BONDS ☐ |

9(e) WE ARE IN RECEIPT OF SBA FORM 912 ☐ AND APPROPRIATE SBA FORM 994 FOR THIS CONTRACTOR AND JOB ☐

| | | |
|---|---|---|
| 10. RECOMMENDATION ☐ | APPROVAL ☐ | DISAPPROVAL |

| | | |
|---|---|---|
| 11. REVIEWING OFFICIAL (Signature) | TITLE<br>Surety Bond Assist. | DATE [illegible] |
| APPROVING OFFICIAL (Signature) | TITLE<br>Acting ARD/F&I | DATE<br>[illegible] |

SBA Form 994B (2-73)

SMALL BUSINESS ADMINISTRATION

## GUARANTEE AGREEMENT UNDER TITLE IV, PART B, OF THE SMALL BUSINESS INVESTMENT ACT OF 1958, AS AMENDED

This agreement, made and entered into this ________ day of ____________________, 19___,

by and between the Small Business Administration, an agency of the United States Government, hereinafter referred as SBA and

American Fidelity Fire Insurance Company, hereinafter referred to as Surety,

relative to ____________________ hereinafter referred to as Principal,

who has applied for bonds required for ________________________________________
(describe project)

________________________________________________________________

________________________________________________________________

WITNESSETH: That in consideration of the mutual covenants and agreements herein contained, the parties agree as follows:

1. Surety agrees, conditional on the execution of this guarantee by SBA, to become surety on the bid bond and if Principal's bid price is in line with other bidders in Surety's opinion and the contract price does not exceed $500,000, to become surety on performance, payment, maintenance, or any other bonds necessary or incidental to the performance of the above described contract executed on behalf of the Principal. The agreement in this paragraph shall not apply unless all prescribed underwriting conditions are met, nor shall it apply if subsequent or additional information comes to the attention of the Surety of a nature to change its underwriting decision as to the desirability of executing any of the aforementioned bonds.

2. Surety represents that such bond or bonds when executed by it as to terms and conditions will be in accord with those executed by professional sureties for the type of contract for which such bond or bonds are required to be furnished by Principal.

3. Surety affirms that without this SBA guarantee to Surety it will not issue any of said bonds to Principal.

4. SBA hereby agrees to guarantee to Surety 90% of any "loss" Surety may sustain or incur in good faith by reason of its execution of the bid, payment or performance bond contemplated by this Agreement.

5. SBA agrees that the term "loss" as used in this Agreement shall mean any and all liability, damages, court costs, counsel fees, charges and expenses of whatever kind or nature which the Surety shall or may, at any time, sustain or incur by reason, or in consequence, of having executed the bond or bonds herein guaranteed by SBA.

6. The Surety shall be entitled to credit for any and all disbursements, in and about the matters herein contemplated, made by it in good faith under the belief that it is or was liable for the sums and amounts so disbursed, or that it was necessary or expedient to make such disbursement (including efforts to diminish "loss"), whether such liability, necessity or expediency existed or not, and vouchers or other evidence of such disbursement shall be taken as prima facie evidence against SBA of the fact and extent of SBA's liability to Surety.

7. SBA agrees that Surety shall be entitled to reimbursement on a calendar quarterly basis under this guarantee for its loss, adjusted pro rata for any payments received by Surety from any other source.

SBA FORM 990 (3-72) PREVIOUS EDITIONS ARE OBSOLETE

UNITED INSPECTION BUREAU, INC.
Insurance Adjusters

3550 Wilshire Boulevard
Los Angeles, Calif 90010
(213) 386-2378

August 22, 1977

**WHEN REPLYING REFER TO:**

Bond No. 04-021-2219794

Mr. Dann Gibb
Chief Underwriter
Surety Bond Guarantee Underwriting Division
Small Business Administration
1441 L Street, N.W.
Washington, D.C. 20416

PRINCIPAL: SPIGHT LANDSCAPE CONTRACTORS INCORPORATED
BOND NO. : 04-021-2219794
SBG NO. : 68344-14

Dear Mr. Gibb:

The following is pursuant to required notification procedures.

The surety received notice that our principal had been defaulted on this contract because of its failure to complete the work on time, the poor quality of his work on this project and the extensive corrective work necessary. This project is landscape contract involving planting of trees with a one year maintenance provision to provide for any trees that may have died within maintenance period. Not only has the contract not been completed but there is a large percentage of the trees our principal planted which have died which must be replaced. The surety's attorney is in the process of arranging for completion of this project and necessary corrective work and you will be advised once these arrangements have been made.

It would appear at that time that the corrective work necessary might cost as much as $5,400 and that the cost to complete the principal's contract might cost approximately $3,200. In addition, this contract calls for liquidated damages of $50 a day from the last adjusted completion date of April 6, 1977, and will keep on accruing until the project is completed. This could result in additional liability in the amount of approximately $12,000. However, the surety's attorney will attempt to negotiate with the obligee to have these liquidated damages either completely waived or reduced somewhat. In addition, the surety will be responsible for the one year maintenance guarantee which could involve approximately $5,000. All this ~~perpetual~~ liability would be against the performance bond obligation.

There do not appear to be any labor and material payment bond claims against the bond, but the surety's attorney is currently investigating in this regard since it appears that our principal is close to being insolvent.

There are remaining contract funds available to offset the surety's losses in the amount of $17,150.

Please set up a reserve at this time of $14,000 which would include an estimate of $5,000 for possible payment bond claims. Should the status of this matter change you will be advised and an appropriate reserve recommendation made.

In addition, the surety's attorney is investigating the possibility of indemnity recovery and in this regard has received assurances from our principal that he is trying to obtain financing and that he would assign to the surety equity in his real property. However, you will be further updated in this regard.

Very truly yours,

Perry Lisker
Manager, Surety Bond Claims Department

SH:jb

cc: American Fidelity Fire Insurance Company
Attorney-In-Fact
SBA Regional Office

UNITED INSPECTION BUREAU, INC.
Insurance Adjusters

3550 Wilshire Boulevard
Los Angeles, Calif. 90010
(213) 386-2378

September 7, 1977

Chief Underwriter
Surety Bond Guarantee / Underwriting Division
SMALL BUSINESS ADMINISTRATION
1441 "L" N.W.
WASHINGTON, D.C. 20416

**WHEN REPLYING REFER TO:**
SURETY: AFFI
BOND NUMBER 04-021-2219794

Attention: Mr. Danny Gibb

Re: PRINCIPAL Spight Landscape Contractors, Inc.
SBG NO: C2344-14

Dear Mr. Gibb:

The above referred to Surety has been notified as follows:

☐ Demand upon the Surety by a payment bond claimant.

☒ Demand against the performance bond by the Obligee.

☐ Notification of potential payment bond claim.

☐ Notification from obligee that principal is experiencing financial difficulties, or has not been performing contract work satisfactorily, and that there is a possibility that the obligee may make a demand upon the performance bond in the future.

The purpose of this letter is merely to inform the Small Business Administration of information received by the Surety regarding the possibility of a claim or a potential claim against the captioned bond. This matter will be promptly investigated and upon completion of same, the Small Business Administration will be provided with a comprehensive report explaining whether it is anticipated that the above bond will incur a net loss.

Very truly yours,

Perry Lisker /cls

Perry Lisker
Manager, Surety Bond Claims Department

cc: Mr. Jud Simpkins
Surety Bond Guarantee Officer
Small Business Administration
1720 Regal Row - Suite 230
Dallas, Texas 75235

cc: "attorney in fact."

PL:cls

U.S. SMALL BUSINESS ADMINISTRATION
WASHINGTON, D.C. 20416

Date: December 21, 1977

Reply to Attn of: SBG:WG

Subject: Contractor Reinstatement
Re: Spight Landscape
SBG 68344

To: Judd Simpkins, Region VI
Surety Bond Officer
Regional Office; Dallas, Texas

Your file is enclosed for re-establishment in your normal underwriting portfolio.

Danny J. Gibb
Chief Underwriter
Surety Bond Guarantee

Enclosure

RECEIVED
JAN 9 [illegible]
REGION VI - SBA

5

*United Inspection Bureau, Inc.*
*Surety Bond Claims*

*15910 Ventura Boulevard, Encino, California 91436*
*telephone (213) 788-9420*

March 30, 1978

Mr. Dan Gibb, Chief Underwriter
Surety Bond Guarantee
Underwriting Division
Small Business Administration
1441 "L" Street N. W.
Washington, DC 20416

RE: Principal: Spight Landscape Contractors, Inc.
Bond No.: 04-512-1876834
SBG No.: 30192-03 Same as 68344-14 ??
Claim No.: 617170

Dear Mr. Gibb:

The purpose of this letter is to confirm your conversation with Perry Lisker on 12/20/77 wherein you and Mr. Lisker agreed that .J. Pilet Insurance Agency, Inc. had the authority to write additional SBA guaranteed bonds for the above captioned principal.

Should you have any questions regarding this matter, please contact me at your earliest convenience.

Very cordially yours,

James A. Hillery
Claims Attorney

JH:kr

*Authorized Representative of American Fidelity Fire Insurance Company, Woodbury, New York*

[illegible] BUSINESS ADMINISTRATION

APPLICATION FOR SURETY BOND GUARANTEE ASSISTANCE

[illegible]

Spight Landscape Contractors, Inc.

[illegible] HOME ADDRESS (STREET, CITY AND STATE [illegible] ZIP)

me as business

[illegible] PAL'S BUSINESS ADDRESS [illegible] COUNTY AND ZIP Orleans Parish, LA
001 Old Gentilly Road,
ew Orleans, LA 70127

[illegible] EMPLOYER [illegible] NUMBER

2-072175

TO BE COMPLETED BY BROKER/AGENT (Producer)

[illegible] SURETY

[illegible] Fidelity Fire Insurance Co.

NAME OF BROKER AGENT (Producer)

A. J. Pilet Insurance Agency, Inc.

BROKER AGENT (Producer's) STREET, CITY AND STATE (Include COUNTY AND ZIP) 6027 Chef Menteur Hwy
New Orleans, Orleans Parish, LA 7012[illegible]

BROKER AGENT (Producer's) TELEPHONE NUMBER (Include Area Code)

(504-245-0453)

BROKER AGENT (Producer's) EMPLOYER ID NUMBER

(72-0700083)

[illegible] hereby states and affirms the following:

The [illegible] gross [illegible] of my business (including affiliates as set forth in Part 121 of SBA's Rules and Regulations) during the last fiscal year was $180,817 [illegible] annually averaged over the past 3 fiscal years, was $ ________ (to the nearest [illegible]). Type of business: ☐ Proprietorship, ☐ Partnership, ☒ Corporation.
First business formed 1974 Joint Venture ☐ Yes XX No

A bid, payment or performance bond is required on the following project in order for me to serve as a XX primary contractor or subcontractor thereon.

Contractor certifies having attempted (and failed) to obtain the required bonds without the SBA's guarantee; furthermore, the contractor certifies being aware that some sureties charge higher premium rates for bonds than others do, in accordance with [illegible] rate schedules filed in various states.

(1) Brief description of this contract work: landscaping and related work
(2) Estimated time required for completion: four (months)
(3) Anticipated project start date: mo. 2 day 20 yr. 77 (4) Projected completion date: mo. 6 day 20 yr. 77
Project Location: W.B.R.Parsh, LA (6) Name of ☒ obligee or ☐ Prime Contractor: State of Louisiana, Dept. of Highways
[illegible] value of contract $ 100,000

Applicant, in consideration of assistance from the SBA, herewith agrees it will comply with the nondiscrimination requirements of [illegible] 13 Code of Federal Regulations, Part 112 and Part 113.

SBA is authorized to request this information under Executive Order 11625. It will be used only for statistical purposes. You are [illegible] required to disclose this information. Failure to do so will not affect your application.
[illegible] Principal is: ☐ Veteran ☐ Vietnam-Era Veteran or XX Non Veteran (Check one)
[illegible] Principal is: XX Male ☐ Female
(3) Principal is (1) ☐ Black (2) ☐ Puerto Rican, (2) ☐ American Indian, (3) ☐ Hispanic (Includes Mexican-American, Cuban, Central or South American, or others of Spanish Descent, (4) ☐ Asian (Includes persons of Chinese, Japanese, Korean, [illegible] Descent, Aleuts [illegible] Indians, Samoans, Polynesians and Micronesians, (5) ☐ Eskimos and Aleuts (6) ☐ Undetermined [illegible] X [illegible] (including Caucasians).

The date, time and place of the bid opening is as follows (if applicable):
Date 1/26/77 Time 8 am Place Baton Rouge, LA

[illegible] Processing Fee [illegible] section reverse side, and agree to abide by this fee schedule. PROVIDED I receive the [illegible] agree to pay the contractor's SBA's processing fee to my Agent/Broker in [illegible] with Paragraph 9 reverse side.

[illegible] SBA Loan. I ☐ do have an SBA Loan through the SBA Office in ________
with a balance of $ ______ as of (Date) ______ Loan No. ______

XX am not an SBA 8(a) Qualified Contractor (Approved business plan on file)
[illegible] ☐ does not pertain to an 8(a) contract
[illegible] X request Management Assistance.
[illegible] XX previously received SBA Management Assistance.

7\. I ☒ have ☐ have not received previous SBA bond guarantee, either under this trade name or another
If under another trade name, specify:
Trade Name: ________
City/State: ________
When? 19 ___ to 19 ___

[illegible] you ever defaulted on any previous surety bonds (SBA or other) (either under this contracting concern's trade name [illegible] concern(s) of which you have been a principal)? ☐ Yes ☒ No
[illegible] detailed particulars are to be attached to all four (4) copies of this application form. Particulars should [illegible] at least the following: (1) Name of Surety; (2) Name of obligee; (3) SBG No. with suffix Number, if applicable [illegible] Value of Contract; (5) Date of Default; (6) Status of Default/Claim, i.e., amount of loss to Surety, etc; (7) Contrac[illegible] explanation as to reason for default and actions taken to meet the obligations to the Surety under term of [illegible].

[illegible] hereby authorizes any agent, broker, surety company or financial institution in possession of credit, financial [illegible] experience information concerning the undersigned applicant and the applicant's business to release the same to SBA in order that SBA may evaluate the same for the purpose of bond guarantee assistance. Applicant certifies that any [illegible] he submits to any agent, broker or surety company for their evaluation as to the bondability of this contractor [illegible] and accurate to the best of the contractor's knowledge.

[illegible] knowingly false statement in this application or willful misrepresentation relative thereto is a violation of federal [illegible], which may subject you to criminal and civil prosecution, 18 U.S.C. Sections 287, 371, 1001; 15 U.S.C. Section 645; [illegible] Section [illegible] carrying fines up to $10,000 and imprisonment up to five years.

[illegible] I hereby certify that all information presented herein is complete and accurate to the best of my knowledge. [illegible] agree to notify SBA, in writing, of any fee(s) paid by me or my designee(s) to the Surety and/or it's representatives which are in excess of the fee structure noted in Paragraph 3, above, and specified in Paragraph 9, reverse side. [illegible] a separate sheet, detailing amount of such excessive fee(s) and purpose thereof).

[illegible] (Applicant) Spight Date ______

TO BE COMPLETED BY SBA
DATE REC'D. BY SBA 1/12/77
BY (NAME) Paw
SBG NO. 0600-68349-020-51

[illegible] EDITIONS ARE OBSOLETE
[illegible] SURETY
[illegible] PRODUCER AGENT [illegible]

U.S. SMALL BUSINESS ADMINISTRATION

## SURETY BOND GUARANTEE UNDERWRITING REVIEW

PART I SURETY'S REVIEW

SURETY COMPANY
American Fidelity Fire Ins. Co.

NOTE: Items 1-17 are to be completed on each guarantee submission to SBA including the initial and all subsequent submissions

CONTRACTOR, CONTRACTOR'S NAME & ADDRESS (Inc. County & Zip)
Spight Landscape Contractors, Inc.
10001 Old Gentilly Road
New Orleans, LA 70127
Orleans Parish, XLA

THIS FORM IS MANDATORY. NO SURETY SUBSTITUTE WILL BE ACCEPTED BY SBA.

1(a). JOB DESCRIPTION AND LOCATION (Including obligee)
State Proj. No. 450-08-17, landscaping and related work, Westover-Port Allen Highway, for the State of Louisiana, Dept. of Highways,
SUBCATEGORY CODE(S) OF CONTRACT TYPE ______ (APPENDIX 8 SOP 50 45) Baton Rouge, LA

1(b). CONTRACTOR IS XX PRIME OR ☐ SUB-CONTRACTOR ON THIS JOB

1(c). SURETY ASSOCIATION OF AMERICA'S RATING MANUAL (Contract section) REFERENCE ______ CLASS ______

1(d). TYPE OF CONTRACT
☐ CONSTRUCTION ☐ SERVICE ☐ SUPPLY X OTHER (Specify) landscaping

|  |  |  |
|---|---|---|
| 2(a). CONTRACT AMOUNT<br>$ n/a | 2(b).<br>☐ NEGOTIATED ☐ BID | 2(c). IF BID WHAT IS 2ND LOW BID?<br>$ % ☐ N/A |
| 3(a). BOND AMOUNT (Bid)<br>$ 100,000 (5%) | PERFORMANCE<br>$ n/a | PAYMENT<br>$ n/a |
| 3(b). IF PENALTY CLAUSE AMT/WORKING OR CALENDAR DAY?<br>$ uknown | 4. PRESENT PROJECT SIMILAR TO PREVIOUS WORK PERFORMED<br>XX YES ☐ NO | 5. BOND REQUIRED BY ORIGINAL CONTRACT DOCUMENT<br>XX YES ☐ NO |
| 6(a). SCHEDULED STARTING DATE<br>2/20/77 | 6(b). SCHEDULED COMPLETION DATE<br>6/20/77 | 6(c). CONTRACTOR STARTED JOB YET ☐ YES X NO IF YES DATE STARTED<br>IF YES ATTACH BOND BENEFICIARY REPORTS |

7. WORK IN PROGRESS

|  |  |  |  |
|---|---|---|---|
| 7(a). WORK IN PROGRESS STATUS REPORT ATTACHED IF NO REVIEW YOUR FILE AND ATTACH YOUR REPORT OR SBA FORM 994F<br>YES XXX ($22,300) | 7(b). VERIFIED BY OBLIGEES<br>☐ YES X NO | 7(c). HOW MANY?<br>0 | 7(d). OF HOW MANY<br>0 |
| 7(e). HAS SURETY CHECKED W/SUPPLIERS<br>YES X NO | 7(f). HOW MANY<br>0 | 7(g). OF HOW MANY<br>0 | 7(h). PAYABLES CURRENT?<br>☒ YES ☐ NO IF NO PROVIDE SPECIFICS |

8. FINANCIAL STATEMENT

COPY OF CURRENT FINANCIAL STATEMENTS (Company & personal) ☐ ATTACHED OR ☒ ALREADY ON FILE W/SBA
NOTE: THESE STATEMENTS MUST BE SIGNED AND DATED BY PRINCIPALS

|  |  |  |
|---|---|---|
| 8(a). DATE OF FINANCIAL STATEMENT<br>9/30/76 | 8(b). FISCAL YEAR ENDS<br>9/30 | 8(c). FINANCIAL STATEMENT PREPARED BY WHOM?<br>Thomas Payton, Accountatn |
| 8(d). F/S SHOW DISCLAIMER<br>☐ YES ☒ NO | 8(e). TYPE OF FINANCIAL STATEMENT<br>☐ CASH ☐ SIMPLE ACCRUAL XX COMPLETED CONTRACT ☐ % OF COMPLETION ☐ OTHER (Specify) |  |
| 8(f). NET WORTH<br>$ 181,854 COMPANY; $ 126,773 PERSONAL |  | 8(g). NET QUICK ASSETS<br>$ 149,401 COMPANY; $ 1,550 PERSONAL |
| 8(h). WORKING CAPITAL<br>$ 109,216 COMPANY. $ 1,491 PERSONAL |  | 8(i). WORKING CAPITAL SUFFICIENT<br>XX YES ☐ NO IF "NO" HOW MUCH IS NEEDED? SOURCE? |
| 9(a). SCHEDULE OF AGED PAYABLES & RECEIVABLES ATTACHED<br>YES X NO | 9(b) VERIFICATION OF PAYABLES?<br>☐ YES X☐ NO; %0 OVER 60 DAYS 0 % | 9(c). VERIFICATION OF RECEIVABLES?<br>☐ YES ☒ NO; % OVER 60 DAYS 0 % |

10. BANK RELATIONS

|  |  |  |  |
|---|---|---|---|
| 10(a). SURETY VERIFIED BANK BALANCE<br>YES XXX NO | 10(b). AVERAGE BANK BALANCE<br>$ 8,000 | 10(c). CONTRACTOR HAVE BANK LINE OF CREDIT<br>☒ YES ☐ NO | 10(d). HOW MUCH? (Gross)<br>$ open |
| 10(e). WITH WHOM?<br>Republic National Bank |  | 10(f). HOW MUCH PRESENTLY OWING<br>$ -0 - | 10(g). HOW MUCH L/C PRESENTLY UNUSED?<br>$ all unused |

11. BONDING AVAILABILITY

|  |  |  |
|---|---|---|
| 11(a). CONTRACTOR HAVE SURETY BONDING LINE?<br>YES ☒ NO | 11(b). IF YES WHAT AMOUNT<br>$ | 11(c). SURETY BONDING LINE WITH? |

11(d). INDEMNITIES POSTED? (Company and personal) XX YES ☐ NO IF "NO" ATTACH EXPLANATION
IF "YES" ATTACH COPIES OF INDEMNITY AGREEMENTS AND PERSONAL FINANCIAL STATEMENTS ON ALL INDEMNITORS (Including those of third parties unless previously submitted to SBA)

12. HAS SURETY REQUIRED EXTRA COLLATERAL i.e. A CD OR CASHIERS CHECK FROM CONTRACTOR
☐ YES X NO IF YES: WHAT TYPE INSTRUMENT ______ ; AMOUNT $

|  |  |  |
|---|---|---|
| 13(a) SUBCONTRACTOR INVOLVED IN THIS JOB<br>YES X NO | 13(b). IF YES PARTICIPATION<br>% 0 | 13(c). PRINCIPAL SUBCONTRACTOR BONDED<br>☐ YES ☒ NO IF YES, AND BY YOUR COMP. THROUGH THE SBA PROGRAM ATTACH SPECIFICS |

SBA FORM 994B (7-76) PART 1 REF SOP 50 45 PREVIOUS EDITIONS ARE OBSOLETE.

14. DOES SURETY RECOMMEND FINANCIAL/MANAGEMENT/TECHNICAL ASSISTANCE BY SBA? ☐ YES ☒ NO IF YES, WHAT TYPE & WHY

15. CHECKLIST OF REQUIRED ITEMS
X CONTRACTOR APPLICATION FEE ☐ CONTRACT PROCESSING FEE ☒ SBA FORM 994 ☒ SBA FORM 990 ☐ SBA FORM 912 ☒ SBA FORM 994F OR SUBSTITUTE ☐ COPIES OF BONDS IF SPECIAL CONDITIONS ADDED

16. CONTINUATION SHEETS ATTACHED?
☐ YES ☒ NO

17. REMARKS, CONCLUSIONS *(Please specify why this contractor must have SBA's bond Guarantee Assistance and when you anticipate his no longer needing this help.)*

Major markets are not bonding smaller contractors at this time and they will not advise us when they will decide to do so. Therefore, recommend approval until such time as this situation reverses itself.

*Items 18-28 are to be completed on the initial submission and its annual update as requested by SBA*

18. TYPE OF CONTRACTUAL WORK THIS FIRM HAS DONE PREVIOUSLY

| | | | |
|---|---|---|---|
| 19(a). LARGEST PREVIOUS CONTRACT<br>$ | 19(b). LARGEST PREVIOUS WORK PROGRAM<br>$ , # OF JOBS | 20(a). ANY DISPUTES<br>☐ YES ☐ NO IF "YES" ATTACH DETAILS | 20(b). ON SCHEDULE<br>☐ YES ☐ NO IF "NO" ATTACH DETAILS |
| 21(a). CONTRACTOR EVER FAILED TO COMPLETE JOB?<br>☐ YES ☐ NO IF YES ATTACH SPECIFICS | | 21(b). HAS CONTRACTOR EVER DEFAULTED ON A CONTRACT FORCING A SURETY TO SUFFER A LOSS?<br>☐ YES ☐ NO IF YES ATTACH SPECIFICS | |
| 22(a). CONTRACTOR HAVE ADEQUATE EQUIPMENT<br>☐ YES ☐ NO | 22(b). OWNED?<br>☐ YES ☐ NO | 22(c). LEASED?<br>☐ YES ☐ NO | |
| 23. CONTRACTOR TAXES CURRENT<br>☐ YES ☐ NO IF NO ATTACH SPECIFICS | 24. CONTRACTOR INSURANCE COVERAGE SUFFICIENT<br>☐ YES ☐ NO | 25(a). CONTRACTOR PREVIOUSLY BONDED<br>☐ YES ☐ NO | |
| 25(b). LARGEST AMOUNT<br>$ JOB, $ WORK PROGRAM | | 25(c). WITH WHOM | |

25(d). IF CHANGE OF SURETY, WHY?

26. ATTACHED RESUME(S) OF OFFICERS, OWNERS AND/OR KEY EMPLOYEES

| | |
|---|---|
| 27(a). MANAGING AGENCY OF SURETY *(If applicable)* | 27(b). MANAGING AGENCY'S EMPLOYER *(IRS)* I.D. |

28. REMARKS/CONCLUSIONS

IN OUR OPINION THE PRINCIPAL APPEARS TO HAVE THE FINANCIAL/MANAGEMENT/TECHNICAL ABILITIES TO SUCCESSFULLY COMPLETE THIS CONTRACT, HOWEVER, WE FEEL THIS CONTRACTOR FALLS BELOW THE NORMAL UNDERWRITING STANDARD OF OUR COMPANY, AND WE WILL NOT ISSUE BONDS TO THIS CONTRACTOR WITHOUT THE SBA GUARANTEE.

| | | | |
|---|---|---|---|
| SIGNATURE OF UNDERWRITER<br>B. Robillard | | DATE<br>1/10/77 | |
| TYPED NAME<br>Bruce G. Robillard | | TELEPHONE NO. *(Inc. Area Code)*<br>(504) 245-0453 | |
| TITLE OF UNDERWRITER<br>Attorney-in-Fact | AGENCY NAME *(If applicable)*<br>Surety & Spl Mkt Udnerwriters, Inc. | | |
| ADDRESS OF UNDERWRITER<br>6027 Chef Menteur Highway - | CITY<br>New Orleans | STATE<br>LA | ZIP<br>70126 |

TO BE COMPLETED BY SBA

| | | |
|---|---|---|
| DATE RECEIVED BY SBA<br>1-12-77 | BY: *(Initials)*<br>P.w | SBG # W/SUFFIX:<br>0600-68344-020-51 |

SBA FORM 994B (7-76)

## SMALL BUSINESS ADMINISTRATION'S UNDERWRITING REVIEW

1. MEETS SBG SIZE STANDARDS ☑ YES ☐ NO

2. FINANCIAL/MANAGEMENT/TECHNICAL ASSISTANCE REQUESTED OR RECOMMENDED ☐ YES ☑ NO

2(a). BY WHOM?

2(b). WHAT TYPE?

2(c). SBA ACTION TAKEN

3(a). IF NECESSARY ASSISTANCE IS NOT READILY AVAILABLE IN GOVERNMENT HAVE YOU REFERRED APPLICANT TO FUNDED ASSISTANCE PROGRAMS, i.e. MINORITY CONTRACTORS ASSISTANCE PROJECT (MCAP), ETC.? ☐ YES ☐ NO

3(b). IF YES NAME THE PROGRAM(S):

4. BASED ON THE UNDERWRITING DATA SUBMITTED:

4(a). THERE ☑ IS ☐ IS NOT REASON TO EXPECT SUCCESSFUL COMPLETION OF THE CONTRACT

4(b). THE COSTS ☑ DO ☐ DO NOT APPEAR TO BE REASONABLE IN ACCORDANCE WITH STD. SURETY INDUSTRY PRACTICES

5. IT HAS BEEN DETERMINED THAT THE REQUESTED BOND(S) ☑ IS ☐ IS NOT NECESSARY, REQUIRED BY THE CONTRACT DOCUMENT'S TERMS, AND THE SURETY HAS INDICATED THAT IT WILL NOT ISSUE THE BOND(S) WITHOUT THE SBA GUARANTEE. FURTHERMORE, NO ADVERSE DATA CONCERNING THE SURETY'S PREMIUM/FEE SCHEDULE WAS REVEALED IN THE CONTRACTOR'S APPLICATION *(SBA Form 994)*

6. ATTACHMENTS *(Check appropriate boxes)*

| | | | | | |
|---|---|---|---|---|---|
| ☐ | CONTINUATION SHEETS | ✓ | INDEMNITY AGREEMENT(S) | ✓ | SBA FORM 994 |
| ✓ | CONTRACTOR'S CURRENT BUSINESS FINANCIAL STATEMENT | ✓ | PERSONAL FINANCIAL STATEMENT(S) | ✓ | SBA FORM 912 |
| ☐ | RESUMES OF PRINCIPAL(S) OWNER(S) AND OR KEY EMPLOYEES | ✓ | SBA FORM 990 | ✓ | SBA FORM 994F |

7. REMARKS/CONCLUSIONS

$300,300 w.c.
NW $109,216 F/S dtd 9/30/76 without audit
LC - Open
NP $24,399

8. PRINCIPAL'S TRADE NAME Dwight Landscape Contractors Inc.

9. SBG NO. W/SUFFIX 0000 0324 030 51

10. RECOMMENDATION/ACTION

| APPROVE | DISAPPROVE | SIGNATURE | TITLE | DATE |
|---|---|---|---|---|
| ☑ | ☐ | Betty K. Brenton | B. Ast | 1-19-77 |
| ☑ | ☐ | | Acting ARDF+I | 1/19/77 |
| ☐ | ☐ | | | |

SBA FORM 994B (7-76) PART II REF SOP 50 45 PREVIOUS EDITIONS ARE OBSOLETE.

## U.S. SMALL BUSINESS ADMINISTRATION
## SURETY BOND GUARANTEE AGREEMENT

PART I

The Small Business Administration, an Agency of the United States Government, hereinafter called SBA, pursuant to the authority contained in Part B of Title IV of the Small Business Investment Act, as amended, 15 USC Sections 694a and b, and to the regulations issued pursuant thereto, and in consideration of Surety's payment of the SBA's guarantee fee and issuance of the bond(s) requested by the Principal, and in reliance upon the declarations contained in Part I and subject to the terms and conditions contained in Part II, agrees to guarantee the Surety against up to 90 percent of the loss it suffers as the result of the Principal's breach of the terms of the contract bonded.

Surety Name: American Fidelity Fire Insurance Co.

Principal's Trade Name: Spight Landscape Contractors, Inc.

Surety Underwriter's Name: Bruce G. Robillard

Principal's Trade Address: 10001 Old Gentilly Road

Street: New Orleans, LA 70127

Principal's Name: Sydney Spight

City, State, Zip and County: Orleans Parish, LA

DESCRIPTION OF NATURE, LOCATION, AMOUNT AND EXTENT OF WORK TO BE DONE ON:

Contract: State Proj. No. 450-08-17, Westover-Port Allen Highway located in West Baton Rouge Parish, Route I-10, landscaping and related work.

Obligee: State of Louisiana, Dept. of Highways, Baton Rouge, LA

IF SUBCONTRACT ON PUBLICLY-FINANCED PROJECT, SPECIFY BOTH PRIME CONTRACTOR AND PUBLIC SECTOR OBLIGEE

WHERE APPLICABLE THIS AGREEMENT CONFIRMS THE ORAL COMMITMENT MADE BY

Name of SBA Official | Of the SBA Office in (City and State)

To (Name of authorized representative for surety) | Of: (City & State) | On (Date)

This confirmation is being submitted within 15 calendar days of oral commitment, as required by SBA regulations.

This Agreement shall take effect upon signing by the authorized SBA representative, and all terms and conditions inserted herein must be initialed by both SBA and Surety.

Signature of Surety's Authorized Representative: Robillard

Typed Name: Bruce G. Robillard | Title: Atty-in-Fact | Date: 1/10/77

SBA Signature | Title: Acting ARD/F&I | Date: 1/14/77

Typed Name: Jud Sickinga

Action: ☑ Approved ☐ Disapproved ☐ Returned with special conditions (below) ☐ Returned/Withdrawn

In witness thereof, the Small Business Administration has caused this guarantee to be executed this 14 day of Jan. 77. In accordance with published SBA regulations, SBA Guarantee Equals 90 %.

Conditions By SBA Only ☐ Yes ☑ No (If "Yes", specify)

Signature (For Special Conditions) | Date | SBA Signature (for Special condition(s), if approved by Surety) | Date

Accept or Decline

PLEASE COMPLETE WHEN DATA IS AVAILABLE

Items 1-6 to Be Completed for ALL Submissions

1. Date bids to be opened (If applic.) 1/25/77 [illegible] AM
2. Estimated Contract Amount $100,000
3. Contract ☒ Bid ☐ Negotiated
4. Bonds Required X Bid ☐ Payment ☐ Performance
5. Bond Amount (%) 5 Bid Payment Performance
6. Contract Awarded (If "yes", complete Items 7-14) ☐ Yes ☒ No

Items 7-14 to be Completed Only for Contracts Awarded.

7. Date of Contract Award
8. Amount of Contract
9. SBA Processing Fee From Contractor $
10. Bond Amounts Bid $ Payment $ Performance $
11. Premium Charged $ %
12. Bond Numbers Bid Payment Performance #
13. Project for: ☐ Federal ☐ State ☐ Local ☐ Special District ☐ Private ☐ Other
14. If awarded or was Bid BID SPREAD: Low $ 2nd Low $ 3rd Low $ Highest $

TO BE COMPLETED BY SBA

Guarantee Number: 0603-68344-020-51 | Date Received: 1-12-77 | By: Name paw

U.S. SMALL BUSINESS ADMINISTRATION

## SURETY BOND GUARANTEE AGREEMENT

PART I

The Small Business Administration, an Agency of the United States Government, hereinafter called SBA, pursuant to the authority contained in Part B of Title IV of the Small Business Investment Act, as amended, 15 USC Sections 694a and b, and to the regulations issued pursuant thereto, and in consideration of Surety's payment of the SBA's guarantee fee and issuance of the bond(s) requested by the Principal, and in reliance upon the declarations contained in Part I and subject to the terms and conditions contained in Part II, agrees to guarantee the Surety against up to 90 percent of the loss it suffers as the result of the Principal's breach of the terms of the contract bonded.

Surety Name: American Fidelity Fire Insurance Co.

Principal's Trade Name: Spight Landscape Contractors, Inc.

Surety Underwriter's Name: Bruce G. Robillard

Principal's Trade Address: 10001 Old Gentilly Road

Street: New Orleans, LA 70127

Principal's Name: XX Sydney Spight

City, State, Zip and County: Orleans Parish, LA

DESCRIPTION OF NATURE, LOCATION, AMOUNT AND EXTENT OF WORK TO BE DONE ON:

Contract: State Proj. No. 450-08-17, Westover-Port Allen Highway located in W. Baton Rouge Parish, Route I-10, landscaping and related work.

Obligee: State of Louisiana. Dept. of Highways, Baton Rouge, LA

RECEIVED
JAN 10 1978
REGION VI, SBA

IF SUBCONTRACT ON PUBLICLY-FINANCED PROJECT, SPECIFY BOTH PRIME CONTRACTOR AND PUBLIC SECTOR OBLIGEE

WHERE APPLICABLE THIS AGREEMENT CONFIRMS THE ORAL COMMITMENT MADE BY

Name of SBA Official:

Of the SBA Office in (City & State):

To (Name of authorized representative for surety):

Of: (City & State)

On (Date)

This confirmation is being submitted within 15 calendar days of oral commitment, as required by SBA regulations.

This Agreement shall take effect upon signing by the authorized SBA representative, and all terms and conditions inserted herein must be initialed by both SBA and Surety.

Signature of Surety's Authorized Representative: Robillard

Typed Name: Bruce G. Robillard

Title: Atty-in-Fact

Date: 1/10/77

SBA Signature:

Typed Name: Jud Simkins

Title: Acting ARD/F&I

Date: 1/19/77

Disposition: [✓ Approved] ☐ Disapproved ☐ Returned/Withdrawn ☐ Returned with special conditions (below)

In witness whereof, the Small Business Administration has caused this guarantee to be executed this 19 day of Jan 77 in accordance with published SBA regulations, SBA Guarantee Equals 90 %.

Special Conditions By SBA Only ☐ Yes ☑ No (If "Yes", Specify)

| | | | |
|---|---|---|---|
| Surety Signature (For Special Conditions)<br>Approve Decline | Date | SBA Signature (for Special condition(s), if approved by Surety) | Date |

PLEASE COMPLETE WHEN DATA IS AVAILABLE

Items 1-6 to be Completed for ALL Submissions

| | | |
|---|---|---|
| 1. Date and time bids to be opened (if applic.)<br>1/12/77-- 8 am | 2. Estimated Contract Amount:<br>$100,000 | 3. Contracts<br>☒ Bid ☐ Negotiated |
| 4. Bonds Required<br>X Bid ☐ Payment ☐ Performance | 5. Bond Amount (%)<br>5 Bid Payment Performance | 6. Contract Awarded (If "yes", complete items 7-13)<br>☐ Yes YY ☐ No |

Items 7-14 to be Completed Only for Contracts Awarded

| | | |
|---|---|---|
| 7. Date of Contract Award<br>7/77 | 8. Amount of Contract<br>$54,557.00 | 9. SBA Processing Fee From Contractor<br>$109.00 |

10. Bond Amounts Bid $ Payment $ Performance $54,552.00

11. Premium Charges $817.65 1½% 6.54/11.40

12. Bond Numbers 04-021-215003 Payment # Performance #

13. Project for: ☐ Federal ☒ State ☐ Local ☐ Special District ☐ Private ☐ Other

14. If awarded job was Bid, BID SPREAD:

Low $54,557.00 2nd Low $61,225.55 3rd Low $97,937.70 Highest $ NO OTHERS

TO BE COMPLETED BY SBA

SBA PREFIX: 0600-68344-020-51

Date Received: 1-12-77

By: Name: pse

*United Inspection Bureau, Inc.*
*Surety Bond Claims*

*15910 Ventura Boulevard, Encino, California, 91436*
*telephone (213) 788-9420*

7

August 5, 1980

AUG 0 8 1980

Mr. Howard Huegel
Claims Manager
Surety Bond Guarantee
Small Business Administration
1815 N. Lynn, Room 301
Rosslyn, VA 22209

Re: Principal: Spight Landscape Contractors, Inc.
Bond No : 04-021-2650003
SBG No : 0600-68344-020-51

Dear Mr. Huegel:

The following is pursuant to required notification procedures and you may consider this your initial default notification. I would recommend, at this time, that the principal's file continue to be pulled from the field and that no further bonding be issued. This file should have been pulled a while back due to prior defaults.

The Surety issued a Performance Bond in the amount of $54,582.00 and a Payment Bond in a like amount with reference to the above-captioned project.

This bond covered a contract for certain landscape work along Fort Allan Highway, also known as Interstate 10. The Surety's attorney is currently investigating the surrounding circumstances of this default and the status of the project. Your office will be further updated when his report becomes available.

Please establish a reserve of $8,000.00 to cover the potential liability of the Surety under its Performance and Payment Bonds, investigation costs, attorney's fees and claims adjustment expenses. Your office will be further updated if there is any need to adjust these reserves upon receipt of outside counsel's report.

The Surety's attorney is also investigating the possibility of indemnity recovery and your office will be further updated in this regard also.

Very truly yours,

David A. Pines
Claims Attorney

cc: AFFIC
Attorney in Fact; SBA Regional Office

*Authorized Representative of American Fidelity Fire Insurance Company, Woodbury, New York*

[illegible] ADMINISTRATION

## APPLICATION FOR SURETY BOND GUARANTEE ASSISTANCE

TO BE COMPLETED BY PRINCIPAL
NAME OF PRINCIPAL
Spight Landscape Contractors, Inc.
PRINCIPAL'S HOME ADDRESS STREET, CITY AND STATE (Include ZIP)
same as busines
PRINCIPAL'S BUSINESS ADDRESS STREET, CITY AND STATE (Include COUNTY AND ZIP) 10001 Old Gentilly Rd.
New Orleans, LA 70127
Orleans Parish, Louisiana
PRINCIPAL'S EMPLOYER ID NUMBER
72-0872175

TO BE COMPLETED BY BROKER AGENT (Producer)
NAME OF SURETY
[illegible] Fidelity Fire Insurance Co.
NAME OF BROKER/AGENT (Producer)
A. J. Pilet Insuranee Agency, Inc.
BROKER AGENT (Producer's) STREET, CITY AND STATE (Include COUNTY AND ZIP) 6027 Chef Menteur Hw
New Orleans, Orleans Parish, LA 7012
BROKER AGENT (Producer's) TELEPHONE NUMBER (Include Area Code)
(504-245-0457)
BROKER AGENT (Producer's) EMPLOYER ID NUMBER
(72-0700085)

Applicant hereby states and affirms the following:

The annual gross receipts of my business (including affiliates, as set forth in Part 121 of SBA's Rules and Regulations) during the past fiscal year was $180,817 , or, as annually averaged over the past 3 fiscal years, was $ ________ (to the nearest hundreds). Type of business: ☐ Proprietorship, ☐ Partnership, ☒ Corporation.
Year Business Formed: 1974 Joint Venture ☐ Yes ☒ No

A bid, payment or performance bond is required on the following project in order for me to serve as a X primary contractor or subcontractor thereon.

Contractor certifies having attempted (and failed) to obtain the required bonds without the SBA's guarantee; furthermore, the contractor certifies being aware that some sureties charge higher premium rates for bonds than other do, in accordance with premium rate schedules filed in various States.

(1) Brief description of this contract work: landscaping and related work.
(2) Estimated time required for completion: four (months)
(3) Anticipated project start date: mo. 2 day 14 yr. 77 (4) Projected completion date: mo. 6 day 14 yr. 77
(5) Project Location: E.B.R.& Ascen Parish (6) Name of ☒ obligee or ☐ Prime Contractor: State of Louisiana, Dept. of Highways, Baton Rou

Approximate value of contract: $ 180,000

Applicant, in consideration of assistance from the SBA, herewith agrees it will comply with the nondiscrimination requirements of Title 13, Code of Federal Regulations, Part 112 [illegible].

SBA is authorized to request this information under Executive Order 11625. It will be used only for statistical purposes. You are not required to disclose this information. Failure to do so will not affect your application.
1) Principal is a ☐ Veteran ☐ Vietnam-Era Veteran or ☒ Non Veteran (Check one)
2) Principal is a ☒ Male ☐ Female
3) Principal is a (1) ☐ Black, (2) ☐ Puerto Rican, (3) ☐ American Indian, (3) ☐ Hispanic (Includes Mexican-American, Cuban, Central or South American persons of Spanish Descent), (4) ☐ Asian (Includes persons of Chinese, Japanese, Korean and Filipino Descent; also, [illegible], Polynesians and Micronesians, (5) ☐ Eskimos and Aleuts (6) ☐ Undetermined (7) ☒ [illegible]

The date, time and place of [illegible] is as follows (if applicable):
Date 1/26/77 Time 8 am Place Baton Rouge, LA

I have read the "Contractor's Processing Fee" section (reverse side) and agree to abide by this fee schedule, PROVIDED I receive the contract sought and SBA extends its guarantee [illegible] to pay the contractor's SBA's processing fee to my Agent/Broker in accordance with Paragraph 9 reverse side.

X do not have an SBA Loan. I ☐ [illegible] SBA Loan. I ☐ do have an SBA Loan through the SBA Office in ________ with a balance of $ ________ as of (Date) ________ Loan No. ________

I am ☒ am not an SBA 8(a) Qualified Contractor (Approved business plan on file)

This bond application ☐ does ☒ does not pertain to an 8(a) contract.

I ☒ have ☐ have not received previous SBA bond guarantee, either under this trade name or another
If under another trade name, specify:
Trade Name: ________
City/State: ________
When? 19 ___ to 19 ___

I ☐ do ☒ do not request Management Assistance.
I ☐ have ☒ have not previously received SBA Management Assistance.

Have you ever defaulted on any previous surety bonds (SBA or other) (either under this contracting concern's trade name or any other concern's of which you have been a principal)? ☐ Yes ☒ No
If "yes", detailed particulars are to be attached to all four (4) copies of this application form. Particulars should include at least the following: (1) Name of Surety; (2) Name of obligee; (3) SBG No. with suffix Number, if applicable (4) Value of Contracts; (5) Date of Default; (6) Status of Default/Claim, i.e., amount of loss to Surety, etc; (7) Contractor's narrative explanation as to reason for default and actions taken to meet the obligations to the Surety under terms of the bond(s).

Applicant hereby authorizes any agent, broker, surety company or financial institution in possession of credit, financial or work experience information concerning the undersigned applicant and the applicant's business to release the same to SBA, in order that SBA may evaluate the same for the purpose of bond guarantee assistance. Applicant certifies that any information he submits to any agent, broker or surety company for their evaluation as to the bondability of this contractor is correct and accurate to the best of the contractor's knowledge.

Any intentionally false statement in this application or willful misrepresentation relative thereto is a violation of federal law, which may subject you to criminal and civil prosecution, 18 U.S.C. Sections 287, 371, 1001; 15 U.S.C. Section 645; 31 U.S.C. Section 231, carrying fines up to $10,000 and imprisonment up to five years.

Certification: I hereby certify that all information presented herein is complete and accurate to the best of my knowledge. I further agree to notify SBA, in writing, of any fee(s) paid by me or my designee(s) to the Surety and/or it's representatives which are in excess of the fee structure noted in Paragraph 3, above, and specified in Paragraph 9, reverse side. (Attach a separate sheet, detailing amount of such excessive fee(s) and purpose thereof).

Signature (Applicant): Sidney Spight Date / /

Title ________

SBA FORM 994 (10-76) REF: SOP [illegible] PREVIOUS EDITIONS ARE OBSOLETE
[illegible] SBA REGIONAL OFFICE [illegible] SURETY
[illegible] SBA DISTRICT OFFICE [illegible] PRODUCER AGENT BROKER

TO BE COMPLETED BY SBA
DATE REC'D. BY SBA 1/12/77
BY: (NAME) Paw
SBG NO. 0600-68344-021-53

U.S. SMALL BUSINESS ADMINISTRATION

## SURETY BOND GUARANTEE UNDERWRITING REVIEW

PART I SURETY'S REVIEW

SURETY COMPANY: American Fidelity Fire Ins. Co.

NOTE: Items 1-17 are to be completed on each guarantee submission to SBA including the initial and all subsequent submissions

CONTRACTORS TRADE NAME & ADDRESS *(Inc. County & Zip)*:
Spight Landscape Contractors, Inc.
10001 Old Gentilly Road
New Orleans, LA 70127
Orelans Parish, LA

THIS FORM IS MANDATORY. NO SURETY SUBSTITUTE WILL BE ACCEPTED BY SBA.

1(a). JOB DESCRIPTION AND LOCATION *(Including obligee)*: State Proj. 450-10-51 & 450-11-14, landscaping & related work, Highland Road-Dutchtown Highway, for the State of La., Dept. of Hig0ays, Baton Rouge, LA

SUBCATEGORY CODE(S) OF CONTRACT TYPE ________ (APPENDIX 8 SOP 50 45)

1(b). CONTRACTOR IS ☒ PRIME OR ☐ SUB-CONTRACTOR ON THIS JOB

1(c). SURETY ASSOCIATION OF AMERICA'S RATING MANUAL *(Contract section)* REFERENCE: CLASS:

1(d). TYPE OF CONTRACT ☐ CONSTRUCTION ☐ SERVICE ☐ SUPPLY ☒ OTHER *(Specify)* landscaping

2(a). CONTRACT AMOUNT $ n;a

2(b). ☐ NEGOTIATED ☐ BID

2(c). IF BID WHAT IS 2ND LOW BID? $ % ☐ N/A

3(a). BOND AMOUNT (BID) $ $180,0-0 (5%)

PERFORMANCE $ n/a

PAYMENT $ n/a

3(b). IF PENALTY CLAUSE AMT/WORKING OR CALENDAR DAY? $ uknown

4. PRESENT PROJECT SIMILAR TO PREVIOUS WORK PERFORMED ☒ YES ☐ NO

5. BOND REQUIRED BY ORIGINAL CONTRACT DOCUMENT ☒ YES ☐ NO

6(a). SCHEDULED STARTING DATE 2/14/77

6(b). SCHEDULED COMPLETION DATE 6/14/77

6(c). CONTRACTOR STARTED JOB YET ☐ YES ☒ NO IF YES DATE STARTED   IF YES ATTACH BOND BENEFICIARY REPORT

7. WORK IN PROGRESS

7(a). WORK IN PROGRESS STATUS REPORT ATTACHED IF NO, REVIEW YOUR FILE AND ATTACH YOUR REPORT OR SBA FORM 994F ☐ YES ☒ NO ($22,300)

7(b). VERIFIED BY OBLIGEES ☐ YES ☒ NO

7(c). HOW MANY? 0

7(d). OF HOW MANY 0

7(e). HAS SURETY CHECKED W/SUPPLIERS ☐ YES ☒ NO

7(f). HOW MANY 0

7(g). OF HOW MANY 0

7(h). PAYABLES CURRENT? ☒ YES ☐ NO IF NO PROVIDE SPECIFICS

8. FINANCIAL STATEMENT

COPY OF CURRENT FINANCIAL STATEMENTS *(Company & personal)* ☐ ATTACHED OR ☒ ALREADY ON FILE W/SBA

NOTE: THESE STATEMENTS MUST BE SIGNED AND DATED BY PRINCIPALS

8(a). DATE OF FINANCIAL STATEMENT 9/30/76

8(b). FISCAL YEAR ENDS 9/30

8(c). FINANCIAL STATEMENT PREPARED BY WHOM? ~~Txx~~ Thomas Payton, Accountatn

8(d). F/S SHOW DISCLAIMER ☐ YES ☒ NO

8(e). TYPE OF FINANCIAL STATEMENT ☐ CASH ☐ SIMPLE ACCRUAL ☒ COMPLETED CONTRACT ☐ % OF COMPLETION ☐ OTHER *(Specify)*

8(f). NET WORTH $181,854 COMPANY; $ 126,773 PERSONAL

8(g). NET QUICK ASSETS $149,401 COMPANY; $ 1,550 PERSONAL

8(h). WORKING CAPITAL $ 109,216 COMPANY. $ 1,491 PERSONAL

8(i). WORKING CAPITAL SUFFICIENT ☒ YES ☐ NO IF "NO" HOW MUCH IS NEEDED? SOURCE?

9(a). SCHEDULE OF AGED PAYABLES & RECEIVABLES ATTACHED ☐ YES ☒ NO

9(b). VERIFICATION OF PAYABLES? ☐ YES ☒ NO; % 0 OVER 60 DAYS 0 %

9(c). VERIFICATION OF RECEIVABLES? ☐ YES ☒ NO; % 0 OVER 60 DAYS 0 %

10. BANK RELATIONS

10(a). SURETY VERIFIED BANK BALANCE ☐ YES ☒ NO

10(b). AVERAGE BANK BALANCE $ 8,000

10(c). CONTRACTOR HAVE BANK LINE OF CREDIT ☒ YES ☐ NO

10(d). HOW MUCH? *(Gross)* $ open

10(e). WITH WHOM? Republic National Ban k

10(f). HOW MUCH PRESENTLY OWING $ -0-

10(g). HOW MUCH L/C PRESENTLY UNUSED? $ all unused

11. BONDING AVAILABILITY

11(a). CONTRACTOR HAVE SURETY BONDING LINE? ☐ YES ☒ NO

11(b). IF YES WHAT AMOUNT $

11(c). SURETY BONDING LINE WITH?

11(d). INDEMNITIES POSTED? *(Company and personal)* ☒ YES ☐ NO IF "NO" ATTACH EXPLANATION   IF "YES" ATTACH COPIES OF INDEMNITY AGREEMENTS AND PERSONAL FINANCIAL STATEMENTS ON ALL INDEMNITORS *(Including those of third parties unless previously submitted to SBA)*

12. HAS SURETY REQUIRED EXTRA COLLATERAL i.e. A CD OR CASHIERS CHECK FROM CONTRACTOR ☐ YES ☒ NO IF YES; WHAT TYPE INSTRUMENT? ; AMOUNT $

13(a). SUBCONTRACTOR INVOLVED IN THIS JOB ☐ YES ☒ NO

13(b). IF YES PARTICIPATION 0 %

13(c). PRINCIPAL SUBCONTRACTOR BONDED ☐ YES ☒ NO IF YES, AND BY YOUR COMP. THROUGH THE SBA PROGRAM ATTACH SPECIFICS

SBA FORM 994B (7-76) PART 1 REF SOP 50 45 PREVIOUS EDITIONS ARE OBSOLETE.

14. DOES SURETY RECOMMEND FINANCIAL/MANAGEMENT/TECHNICAL ASSISTANCE BY SBA? ☐ YES ☒ NO IF YES, WHAT TYPE & WHY

15. CHECKLIST OF REQUIRED ITEMS
X CONTRACTOR APPLICATION FEE
X CONTRACTOR PROCESSING FEE
X SBA FORM 994
X SBA FORM 990
☐ SBA FORM 912
X SBA FORM 994F OR SUBSTITUTE
☐ COPIES OF BONDS IF SPECIAL CONDITIONS APPLY

16. CONTINUATIONAL SHEETS ATTACHED?
☐ YES X NO

17. REMARKS, CONCLUSIONS *(Please specify why this contractor must have SBA's bond Guarantee Assistance and when you anticipate his no longer needing this help.)*

Major markets are not bonding smaller contractors at this time and they will not advise us when they will decide to do so. Therefore, recommend approval until such time as this situation reverses iztsefl.

*Items 18-28 are to be completed on the initial submission and its annual update as requested by SBA*

18. TYPE OF CONTRACTUAL WORK THIS FIRM HAS DONE PREVIOUSLY

19(a). LARGEST PREVIOUS CONTRACT $
19(b). LARGEST PREVIOUS WORK PROGRAM $ , # OF JOBS
20(a). ANY DISPUTES ☐ YES ☐ NO IF "YES" ATTACH DETAILS
20(b). ON SCHEDULE ☐ YES ☐ NO IF "NO" ATTACH DETAILS
21(a). CONTRACTOR EVER FAILED TO COMPLETE JOB? ☐ YES ☐ NO IF YES ATTACH SPECIFICS
21(b). HAS CONTRACTOR EVER DEFAULTED ON A CONTRACT FORCING A SURETY TO SUFFER A LOSS? ☐ YES ☐ NO IF YES ATTACH SPECIFICS
22(a). CONTRACTOR HAVE ADEQUATE EQUIPMENT ☐ YES ☐ NO
22(b). OWNED? ☐ YES ☐ NO
22(c). LEASED? ☐ YES ☐ NO
23. CONTRACTOR TAXES CURRENT ☐ YES ☐ NO IF NO ATTACH SPECIFICS
24. CONTRACTOR INSURANCE COVERAGE SUFFICIENT ☐ YES ☐ NO
25(a). CONTRACTOR PREVIOUSLY BONDED ☐ YES ☐ NO
25(b). LARGEST AMOUNT $ JOB: $ WORK PROGRAM
25(c). WITH WHOM
25(d). IF CHANGE OF SURETY, WHY?

26. ATTACHED RESUME(S) OF OFFICERS, OWNERS AND/OR KEY EMPLOYEES

27(a). MANAGING AGENCY OF SURETY *(If applicable)*
27(b). MANAGING AGENCY'S EMPLOYER *(IRS)* I.D.

28. REMARKS/CONCLUSIONS

IN OUR OPINION THE PRINCIPAL APPEARS TO HAVE THE FINANCIAL/MANAGEMENT/TECHNICAL ABILITIES TO SUCCESSFULLY COMPLETE THIS CONTRACT. HOWEVER, WE FEEL THIS CONTRACTOR FALLS BELOW THE NORMAL UNDERWRITING STANDARD OF OUR COMPANY, AND WE WILL NOT ISSUE BONDS TO THIS CONTRACTOR WITHOUT THE SBA GUARANTEE.

SIGNATURE OF UNDERWRITER: Bruce G. Robillard
DATE: 1/10/77
TYPED NAME: Bruce G. Robillard
TELEPHONE NO. *(Inc. Area Code)*: (504) 245-0453
TITLE OF UNDERWRITER: Attorney-in-Fact
AGENCY NAME *(If applicable)*: Surety & Spl Mkt Unddrwriters, Inc.
ADDRESS OF UNDERWRITER: 6027 Chef Menteur Highway -
CITY: New Orleans
STATE: LA
ZIP: 70126

TO BE COMPLETED BY SBA
DATE RECEIVED BY SBA: 1-12-77
BY: *(Initials)* Paw
SBG # W/SUFFIX: 0620-68344-021-53

SBA FORM 994B (7-76)

SMALL BUSINESS ADMINISTRATION'S UNDERWRITING [illegible]

1. MEETS SBG SIZE STANDARDS

☑ YES ☐ NO

2. FINANCIAL/MANAGEMENT/TECHNICAL ASSISTANCE REQUESTED OR RECOMMENDED

☐ YES ☑ NO

2(a). BY WHOM?

2(b). WHAT TYPE?

2(c). SBA ACTION TAKEN

3(a). IF NECESSARY ASSISTANCE IS NOT READILY AVAILABLE IN GOVERNMENT HAVE YOU REFERRED APPLICANT TO FUNDED ASSISTANCE PROGRAMS, i.e. MINORITY CONTRACTORS ASSISTANCE PROJECT *(MCAP)*, ETC.?

☐ YES ☐ NO

3(b). IF YES NAME THE PROGRAM(S):

4. BASED ON THE UNDERWRITING DATA SUBMITTED:

4(a). THERE ☑ IS ☐ IS NOT REASON TO EXPECT SUCCESSFUL COMPLETION OF THE CONTRACT

4(b). THE COSTS ☑ DO ☐ DO NOT APPEAR TO BE REASONABLE IN ACCORDANCE WITH STD. SURETY INDUSTRY PRACTICES

5. IT HAS BEEN DETERMINED THAT THE REQUESTED BOND(S) ☑ IS ☐ IS NOT NECESSARY, REQUIRED BY THE CONTRACT DOCUMENT'S TERMS, AND THE SURETY HAS INDICATED THAT IT WILL NOT ISSUE THE BOND(S) WITHOUT THE SBA GUARANTEE. FURTHERMORE, NO ADVERSE DATA CONCERNING THE SURETY'S PREMIUM/FEE SCHEDULE WAS REVEALED IN THE CONTRACTOR'S APPLICATION *(SBA Form 994)*

6. ATTACHMENTS *(Check appropriate boxes)*

| | | | | | |
|---|---|---|---|---|---|
| | CONTINUATION SHEETS | ✓ | INDEMNITY AGREEMENT(S) | ✓ | SBA FORM 994 |
| ✓ | CONTRACTOR'S CURRENT BUSINESS FINANCIAL STATEMENT | ✓ | PERSONAL FINANCIAL STATEMENT(S) | ✓ | SBA FORM 912 |
| | RESUMES OF PRINCIPAL(S) OWNER(S) AND OR KEY EMPLOYEES | ✓ | SBA FORM 990 | ✓ | SBA FORM 994F |

7. REMARKS/CONCLUSIONS

(over)

[illegible] Comment & 030.

8. PRINCIPAL'S TRADE NAME: Dwight Landscape Contr. Inc.

9. SBG NO. W/SUFFIX: 06006834402153

10. RECOMMENDATION/ACTION

| APPROVE | DISAPPROVE | SIGNATURE | TITLE | DATE |
|---|---|---|---|---|
| ☐ | ☐ | Betty R. Brenton | SP Asst | 1-19-77 |
| ☑ | ☐ | | Acting ARDPA | 1/19/77 |
| ☐ | ☐ | | | |

SBA FORM 994B (7-76) PART II REF SOP 50 45 PREVIOUS EDITIONS ARE OBSOLETE.

## U.S. SMALL BUSINESS ADMINISTRATION
## SURETY BOND GUARANTEE AGREEMENT

PART I

The Small Business Administration, an Agency of the United States Government, hereinafter called SBA, pursuant to the authority contained in Part B of Title IV of the Small Business Investment Act, as amended, 15 USC Sections 694c and b, and to the regulations issued pursuant thereto, and in consideration of Surety's payment of the SBA's guarantee fee and issuance of the bond(s) requested by the Principal, and in reliance upon the declarations contained in Part I and subject to the terms and conditions contained in Part II agrees to guarantee the Surety against up to 90 percent of the loss it suffers as the result of the Principal's breach of the terms of the contract bonded.

Surety Name: American Fidelity Fire Insurance Co.

Surety Underwriter's Name: Bruce G. Robillard

Principal's Name: Sydney Spight

Principal's Trade Name: Spight Landscape Contractors, Inc.

Principal's Trade Address: 1001 Old Gentilly Road
Street: New Orleans LA 701[illegible]
City, State, Zip and County: Orleans Parish, La

**DESCRIPTION OF NATURE, LOCATION, AMOUNT AND EXTENT OF WORK TO BE DONE ON:**

Contract: State Proj. Nos. 450-10-51 and 450-11-11, landscaping and related work, Highland Road-Dutchtown Highway, Louisiana

Obligee: State of Louisiana, Dept. of XXXXXXXX Highways, Baton Rouge, LA

IF SUBCONTRACT ON PUBLICLY-FINANCED PROJECT, SPECIFY BOTH PRIME CONTRACTOR AND PUBLIC SECTOR OBLIGEE

5. WHERE APPLICABLE THIS AGREEMENT CONFIRMS THE ORAL COMMITMENT MADE BY

Name of SBA Official: 
Of the SBA Office in (City and State):

To (Name of authorized representative for surety): 
Of: (City & State): 
On (Date):

This confirmation is being submitted within 15 calendar days of oral commitment, as required by SBA regulations.

This Agreement shall take effect upon signing by the authorized SBA representative, and all terms and conditions inserted herein must be initialed by both SBA and Surety.

| | | |
|---|---|---|
| Signature of Surety's Authorized Representative: Bruce G. Robillard<br>Typed Name: Bruce G. Robillard | Title: Atty-in-Fact | Date: 1/10/77 |
| SBA Signature:<br>Typed Name: Jud Simkins<br>Disposition: ☑ Approved ☐ Disapproved ☐ Returned with special conditions (below) ☐ Returned Withdrawn | Title: Acting ARD/F&I | Date: 1/19/77 |

In witness thereof, the Small Business Administration has caused this guarantee to be executed this 19 day of Jan 1977 in accordance with published SBA regulations, SBA Guarantee Equals 90 %.

Special Conditions By SBA Only ☐ Yes ☑ No (If "Yes", Specify)

| | | | |
|---|---|---|---|
| Surety Signature (For Special Conditions)<br>☐ Approve ☐ Decline | Date | SBA Signature (for Special condition(s), if approved by Surety) | Date |

**PLEASE COMPLETE WHEN DATA IS AVAILABLE**

Items 1-6 to be Completed for ALL Submissions

| | | |
|---|---|---|
| 1. Date and time bids to be opened (if applic.)<br>1/26/77--8 am | 2. Estimated Contract Amount:<br>$1[illegible]0,000 | 3. Contract:<br>☒ Bid ☐ Negotiated |
| 4. Bonds Required<br>☒ Bid ☐ Payment ☐ Performance | 5. Bond Amount (%)<br>5 Bid Payment Performance | 6. Contract Awarded (If "yes", complete Items 7-14)<br>☐ Yes ☒ No |

Items 7-14 to be Completed Only for Contracts Awarded.

| | | |
|---|---|---|
| 7. Date of Contract Award | 8. Amount of Contract | 9. SBA Processing Fee From Contractor<br>$ |
| 10. Bond Amounts<br>Bid $ Payment $ Performance $ | 11. Premium Charged<br>$ % | |
| 12. Bond Numbers<br>Payment # Performance # | 13. Project for: ☐ Federal ☐ State ☐ Local ☐ Special District ☐ Private ☐ Other | |

14. If awarded job was Bid, BID SPREAD:
Low $ 2nd Low $ 3rd Low $ Highest $

**TO BE COMPLETED BY SBA**

| | | |
|---|---|---|
| # SUFFIX<br>0600-68344-021-53 | Date Received<br>1-12-77 | By: Name<br>pew |

# U.S. SMALL BUSINESS ADMINISTRATION
# SURETY BOND GUARANTEE AGREEMENT

The Small Business Administration, an Agency of the United States Government, hereinafter called SBA, pursuant to the authority contained in Part B of Title IV of the Small Business Investment Act, as amended, 15 USC Sections 694a and b, and to the regulations issued pursuant thereto, and in consideration of Surety's payment of the SBA's guarantee fee and issuance of the bond(s) requested by the Principal, and in reliance upon the declarations contained in Part I and subject to the terms and conditions contained in Part II, agrees to guarantee the Surety against up to 90 percent of the loss it suffers as the result of the Principal's breach of the terms of the contract bonded.

| | |
|---|---|
| Surety Name<br>American Fidelity Fire Insurance Co. | Principal's Trade Name<br>Spight Landscape Contractors, Inc. |
| Surety Underwriter's Name<br>Bruce G. Robillard | Principal's Trade Address:<br>1001 Old Gentilly Road<br>Street |
| Principal's Name<br>Sydney Spight | New Orleans LA 70127<br>City, State, Zip and County<br>Orleans Parish, la |

DESCRIPTION OF NATURE, LOCATION, AMOUNT AND EXTENT OF WORK TO BE DONE ON:

a. Contract

State Proj. Nos. 450-10-51 and 450-11-14, landscaping and related work, Highland Road-Dutchtown Highway, Louisiana

b. Obligee

State of Louisiana, Dept. of ~~XIXXXXXX~~ Highways, Baton Rouge, LA

RECEIVED
JAN 10 1978
REGION VI, SBA

IF SUBCONTRACT ON PUBLICLY-FINANCED PROJECT, SPECIFY BOTH PRIME CONTRACTOR AND PUBLIC SECTOR OBLIGEE

WHERE APPLICABLE THIS AGREEMENT CONFIRMS THE ORAL COMMITMENT MADE BY

| | | |
|---|---|---|
| Name of SBA Official | Of the SBA Office in (City and State) | |
| To (Name of authorized representative for surety) | Of: (City & State) | On (Date) |

This confirmation is being submitted within 15 calendar days of oral commitment, as required by SBA regulations.

This Agreement shall take effect upon signing by the authorized SBA representative, and all terms and conditions inserted herein must be initialed by both SBA and Surety.

| | | |
|---|---|---|
| Signature of Surety's Authorized Representative:<br>Bruce G Robillard<br>Typed Name Bruce G. Robillard | Title<br>Atty-in-Fact | Date<br>1/10/77 |
| SBA Signature<br>Typed Name Jud Simkins<br>Disposition: ☐ Approved ☐ Disapproved ☐ Returned/Withdrawn ☐ Returned with special conditions (below) | Title<br>Acting ARD/F&I | Date<br>1/19/77 |

In witness thereof, the Small Business Administration has caused this guarantee to be executed this 19 day of Jan 77. In accordance with published SBA regulations, SBA Guarantee Equals 90 %.

Special Conditions By SBA Only ☐ Yes ☑ No (If "Yes", Specify)

| | | | |
|---|---|---|---|
| Surety Signature (For Special Conditions)<br>Approve ☐ Decline | Date | SBA Signature (for Special condition(s), if approved by Surety) | Date |

PLEASE COMPLETE WHEN DATA IS AVAILABLE

Items 1-5 to be Completed for ALL Submissions

| | | |
|---|---|---|
| 1. Date and time bids to be opened (if applic.)<br>1/26/77--8 am | 2. Estimated Contract Amount:<br>$180,000 | 3. Contract<br>XX Bid ☐ Negotiated |
| 4. Bonds Required<br>X Bid ☐ Payment ☐ Performance | 5. Bond Amount (%)<br>5 Bid Payment Performance | 6. Contract Awarded (If "yes", complete items 7-14)<br>☐ Yes ☒ No |

Items 7-14 to be Completed Only for Contracts Awarded.

| | | |
|---|---|---|
| 7. Date of Contract Award<br>2-77 | 8. Amount of Contract<br>$107,048.00 | 9. SBA Processing Fee From Contractor<br>$ 214.00 |
| 10. Bond Amounts<br>Bid $ Payment $ Performance $ 107,048.00 | 11. Premium Charged<br>$ 1606.00 1½% | 1285 / 321.00 |
| 12. Bond Numbers<br>Payment # 08-021-366-0004 | 13. Project for: ☐ Federal ☐ State ☐ Local ☐ Special District ☒ Private ☐ Other | |

14. If awarded job was Bid, BID SPREAD:

Low $ 107,045.00 w/SUFFIX 2nd Low $ 162,718.00 3rd Low $ 167,334.30 Highest $ No OTHERS

TO BE COMPLETED BY SBA

| | | |
|---|---|---|
| 0600-68344-021-53 | Date Received<br>1-12-77 | By: Name<br>paw |

*United Inspection Bureau, Inc.*
*Surety Bond Claims*

*15910 Ventura Boulevard, Encino, California, 91436*
*telephone (213) 788-9420*

AUG 0 3 1980

August 5, 1980

Mr. Howard Huegel
Claims Manager
Surety Bond Guarantee
Small Business Administration
1915 N. Lynn, Room 301
Rosslyn, VA 22209

Re: Principal: Spight Landscape Contractors, Inc.
Bond No : 04-021-2650004
SBG No : 0600-68344-021-53

Dear Mr. Huegel:

The following is pursuant to required notification procedures and you may consider this your initial default notification. I would recommend, at this time, that the principal's file continue to be pulled from the field and no further bonding be issued. This file should have already been pulled some time ago, due to prior defaults.

The Surety issued a Performance Bond in the amount of $107,048.00 and a Payment Bond in a like amount with reference to the above-captioned project.

The contract in this matter covers certain landscaping works along public highways in the southern portion of the State of Louisiana around Batonrouge. The Surety's attorney is investigating the surrounding circumstances of this default and this office will update you within the next 60 days pertaining to the information contained in outside counsel's report.

Please establish a reserve of $30,000.00 to cover the potential liability of the Surety on its bonds, investigation costs, attorney's fees and claims adjustment expenses. Your office will be further updated if there is any further need to adjust these figures.

The Surety's attorney is investigating the possibility of indemnity recovery, however, based upon past history with this principal, indemnity recovery seems unlikely. Your office will be further updated in this regard also.

Very truly yours,

David A. Pines
Claims Attorney

cc: AFFIC, Attorney in Fact, SBA Regional Office

*Authorized Representative of American Fidelity Fire Insurance Company, Woodbury, New York*

BRIAN, SIMON, PERAGINE, SMITH & REDFEARN
LAW OFFICES
FORTY-THIRD FLOOR
ONE SHELL SQUARE
NEW ORLEANS 70139

M PAUL SIMON
A MORGAN BRIAN JR
FRANK J PERAGINE
GUY W SMITH
ROBERT L REDFEARN
ROBERT G STASSI
THOMAS R BLUM
H BRUCE SHREVES
JAMES A BURTON
CHRISTOPHER M GUIDROZ
DANIEL J CARUSO

THOMAS J FISCHER
NANCY P McCARTHY
LLOYD N SHIELDS
JOHN C HERBERT
JAY H KERN
STEVEN A JACOBSON
SUZETTE T BECKER

TELEPHONE
(504) 522 3030

July 28, 1980

American Fidelity Fire Insurance Company
c/o United Inspection Bureau
15910 Ventura Boulevard, 14th Floor
Encino, California 91436

Attention: David A. Pines, Esq.
Surety Bond Claims Attorney

Re: Principal: Spight Landscape Contractors
Obligee: City of New Orleans
Project: Perimeter Planting at Armstrong Park
Bond No.: 04-021-2219794
Our ref.: 01060-124

Dear Dave:

As I have told you over the telephone, our executory process action against Mr. and Mrs. Sidney Spight in the captioned matter has proved to be fruitless. The two pieces of property which Mr. and Mrs. Spight used to secure a mortgage in favor of American Fidelity are not available for seizure for two different reasons.

First, the St. Tammany Parish country property, as it turns out, was not even owned by the Spights at the time they executed the mortgage and used that property to secure the promissory note executed by them in September, 1978. As we recently discovered while attempting to have the property seized and sold, they had alienated that property in April, 1978. Thus it was not available for us to seize at this time.

The second piece of property was the Spight's residence in Orleans Parish. A review of the Mortgage Office records reveals that the judgments and other recorded interests against that property far exceed the property's value and therefore render our seizure and sale a waste of time as far as our secured interest is concerned.

Since we have not had any success proceeding by executory process on the mortgage which the Spights gave in favor of American Fidelity, I would like to proceed against them by ordinary process so that we will have a judgment with which we could hopefully garnish wages and/or any other income which either of the Spights may have. So that I can prepare that petition to proceed by ordinary process, I would appreciate your sending me an expense breakdown sheet showing all costs expended by United Inspection Bureau on this case, as well as costs which will be required to close the file.

Thanking you, I am,

Very truly yours,

Lloyd N. Shields

LNS/lw
cc: Mr. A. J. Pilet

MEMO TO FILE

August 18, 1980

From: Perry Lisker

To : David Pines

RE : Spight Landscape Contractors
Obligee: City of New Orleans
Project: Perimeter planting at Armstrong Park
Bond No: 04-021-2219794

Please see letter from Deutsch, Kerrigan & Stiles dated September 22, 1978 signed by Harry S. Anderson for the firm. The thrust of this letter and the attached promissory notes and mortgages would indicate that the law firm played a major role in securing the collateral, so I am somewhat surprised to find out that not all the bases were covered as indicated in Sunny Shields correspondence as it relates to the Department of Transportation and Highway job files. If possible I'd like some explanation as to exactly what their role was in preparing these documents. Further there is some handwritten notes from Joe Cunningham indicating some kind of a pay back subsequent to the signing of these agreements. Was there any formal agreement for periodic or monthly payments pursuant to the loss as established and the collateral as taken. ?

The third item is for you to be sensitive to the fact that because of the collateral taken and my conversation with the Small Business Administration that we in fact represented that this principal was rehabilitatable and did deserve additional bonding. Part of that was based on the fact that a local minority organization in New Orleans indicated that they were vitally interested in the principal and were in fact funding him. That organization is the Interracial Counsel for Business Opportunity see in the file letter dated August 8, 1978. I'd like to have counsel investigate whether or not there has been an ongoing relationship with the I.C.B.O. and whether any of that information had been communicated to Pilet or the Small Business Administration.

## FACT SHEET

| | |
|---|---|
| Principal: | Builders United Construction Company<br>Rogers, Arkansas |
| Obligees: | Jacoway-Herdlinger<br>Springdale, Arkansas<br>Bond No: 600-64227-010-40 |
| | United Lutheran Church<br>Bella Vista, Arkansas<br>Bond No: 600-64227-014-48 |
| Surety: | American Fidelity Fire Insurance Company<br>Woodbury, New York |
| Underwriter: | Market Insurance Corporation<br>Encino, California |
| Claims Adjuster: | United Inspection Bureau<br>Encino, California |
| Cost of Original Contract: | $248,201 |
| Loss to SBA: | $95,093 |

## BACKGROUND

Between August and October 1976, SBA authorized guarantees on two bonds executed by American Fidelity Fire Insurance Company (AFF) for Builders United Construction Company. The individual contracts were for the construction of law offices and a church. They totaled $248,000. Due to financial difficulties, Builders defaulted on the United Lutheran project in September 1977. There were $74,000 in contract funds available at the time of default, and SBA paid the surety in excess of $75,000 to complete this contract.

Builders defaulted on the second bond in February 1978, at which time the project was substantially complete. However, claims from suppliers under the bond have required SBA to reimburse the surety for more than $23,000.

## FINDINGS

Following the defaults, UIB attempted to recover a portion of the surety's loss under the General Indemnity Agreement (GIA) executed by the principals of Builders. However, the indemnitors filed suit against AFF, and the Arkansas Supreme Court ruled that AFF could not pursue recovery because the bonds were written by an agent who was not licensed in the State as an agent of AFF.

Both bonds SBA guaranteed for Builders were issued by an agent who was not licensed as a representative for AFF in Arkansas.

Existing Arkansas law requires that all surety insurance policies be countersigned by a resident licensed agent. In addition, the law prohibits the issuance of such policies unless through an agent who is licensed as a representative of the surety. The required countersignature was not obtained. Therefore, the State Supreme Court determined that the indemnity agreement was void, and the surety was prohibited from pursuing indemnity recovery from Builders or its principals. By not ensuring that a duly licensed agent processed the bond in Arkansas, AFF caused SBA to lose recovery opportunities. Furthermore, the surety did not notify SBA of the Arkansas Supreme Court decision, or otherwise keep SBA up-to-date with respect to the indemnity litigation.

[illegible] – [illegible]

2

SMALL BUSINESS ADMINISTRATION

## APPLICATION FOR SURETY BOND GUARANTEE ASSISTANCE

NAME OF APPLICANT AND ITS PRINCIPAL
Builders United Const Co. Inc

APPLICANT'S HOME ADDRESS (Include ZIP)
Rogers Arkansas 72756

APPLICANT'S BUSINESS ADDRESS (Include ZIP)

NAME OF BROKER/AGENT

BROKER/AGENT'S ADDRESS (Include ZIP)

BROKER/AGENT'S TELEPHONE (Include Area Code)

NAME OF SURETY IF KNOWN

1. Applicant hereby states and affirms the following:
   - a. The gross annual receipts of my business (including affiliates) during the past fiscal year was $ ____________, or as annually averaged over the past 3 fiscal years (to the nearest hundreds) was $ ____________.
   - b. A bid, payment or performance bond is required on the following project or to serve as a primary contractor or subcontractor thereon.
   - c. Contractor certifies having attempted (and failed) to obtain the required bonds without the SBA's guarantee; furthermore, the contractor certifies being aware that some sureties charge higher premium rates for bonds than others do.
   - d. Brief description of project including projected job completion date or, on prequalification, size of job and total work in progress you feel you can handle.
   - e. Approximate value of contract: $ 95[illegible].
   - f. Applicant, in consideration of assistance from the SBA herewith agrees that it will comply with the nondiscrimination requirements of Title 13, Code of Federal Regulations, Part 112 and Part 113.

2. The date, time and place of the bid opening is as follows: (if applicable):

| Date | Time | Place |
|---|---|---|
| [illegible] 10 1976 | 2 pm | Springdale Ark |

3. I have read the "Contractor's Fee" section (reverse side) and agree to abide by this fee schedule, PROVIDED I receive the contract sought and SBA extends its bond guarantee. I also agree to pay the contractor's guarantee fee to my Agent/Broker at the time I receive the bond, in accordance with Paragraph 9, reverse side.

4. I presently ☒ do not have an SBA Loan ☐ previous loan or other program assistance
☐ do have an SBA Loan through the ____________ [illegible] ____________ office
with a balance of $ ____________ as of (date) ____________

5. I ☒ am ☐ am not an SBA 8(a) Qualified Contractor
This bond application ☐ does ☐ does not pertain to an 8(a) contract ☐ does ☐ does not pertain to SBG Bond Line of Credit
☑ have received previous SBA bond guarantee(s) ☐ have not received previous SBA bond guarantee(s)
If you have received previous SBA bond guarantee(s), have you ever defaulted on any of them? (Either under this contracting concern's trade name or any other concern's of which you have been a principal ☐ Yes ☑ No
If "yes", detailed particulars are to be attached to all four(4) copies of this application form. Particulars should include at least the following: (1) Name of Surety; (2) Name of Obligee; (3) SBG #w/Suffix Number; (4) Value of Contract; (5) Date of Default; (6) Status of Default/ Claim, i.e., amount of loss to Surety, etc.; (7) Contractor's narrative explanation as to reason for default and actions taken to meet the obligations to the Surety under terms of the bond(s).

6. Applicant hereby authorizes any agent, broker or surety company in possession of credit, financial or work experience information concerning the undersigned applicant and the applicant's business to release the same to SBA, in order that SBA may evaluate the same for the purpose of bond guarantee assistance.
Applicant certifies that any information he submits to any agent, broker or surety company for their evaluation as to the bondability of this contractor is correct and accurate to the best of the contractor's knowledge.

7. Any intentionally false statement in this application or willful misrepresentation relative thereto is a violation of federal law, which may subject you to criminal and civil prosecution, 18 U.S.C. Sections 287,371,1001, 15 U.S.C. Sections 645, 31 U.S.C. Section 231, carrying fines up to $10,000 and imprisonment up to five years."

I hereby certify that all information presented herein is complete and accurate to the best of my knowledge.

| | |
|---|---|
| SIGNATURE (Applicant) | Executed this date<br>7/30/76 |

SBA Form 994 (10-74) REF: SOP 50 45 PREVIOUS EDITIONS ARE OBSOLETE

SBG#64227-10

WHITE COPY - SBA REGIONAL OFFICE
YELLOW COPY - SBA DISTRICT OFFICE
PINK COPY - SURETY
GOLDENROD COPY - PRODUCER (AGENT/BROKER)

## SURETY BOND GUARANTEE OPERATING PROCEDURES

1. Applicant contacts nearest SBA office which would furnish him the following:
   a. Four copies of SBA Form 994, Application for Surety Bond Guarantee Assistance, from SBA.
   b. SBA Form 912, Statement of Personal History, on first application only, or as required.
2. Applicant proceeds to the surety agent of his choice and furnishes that agent with the following:
   a. Credit information and work experience history normally required by surety underwriters.
   b. Four copies of completed SBA Form 994.
   c. Completed SBA Form 912, on first application only, or as required.
3. Surety agent will forward the original of the SBA Form 994, and the SBA Form 912 (all copies), directly to: Small Business Administration, Surety Bond Guarantee, Regional City SBA Office.
4. **Surety agent will forward a copy of the completed SBA Form 994** to the nearest SBA office.
5. Agent will forward to surety company:
   a. A duplicate copy of the SBA Form 994, keeping fourth copy for his own records.
   b. All other information normally required by surety company to underwrite a bond applicant.
6. Assuming favorable decision to proceed by the underwriters, the surety will forward a summary of underwriting information and a signed and completed SBA Form 990, Guarantee Agreement, for the case in hand directly to the Small Business Administration, Surety Bond Guarantee, Regional City SBA Office.
7. The SBA's Surety Bond Guarantee underwriting review staff will make final determinations as required. Within three (but no more than five days) of receipt of summary underwriting information from the surety. SBA will notify the surety of approval (or disapproval) and return the countersigned Guarantee Agreement to the surety. For those contracts or projects valued at more than $500,000, the SBA field office's SBG underwriting review staff will make recommendations to the Washington Central office's SBG staff for disposition. This procedure will require allowing an extra 10 days of SBA processing time.
8. Assuming the applicant is low bidder, and before entering into a contract to perform the work, applicant will return to the agent to request payment and performance bonds as required.
9. Agent will notify the applicant that upon presentation of the bonds, the applicant will present a check payable to the SBA for the guarantee fee. Agent is to receive the contractor's guarantee fee (as explained below) from applicant prior to issuing the necessary bonds to the contractor. The surety agent will forward the fee directly to the Small Business Administration, Surety Bond Guarantee, Regional City SBA Office.

## CONTRACTOR'S FEE

*The guarantee fee is .2% ($2 per $1000) of contract's face value, or,* in the case of partial bonds, either .2% of the contract's face value or 20% of the premium charged by the Surety, whichever is less. **All contractor guarantee fees are due and payable upon receipt of bonds.**

SMALL BUSINESS ADMINISTRATION

## SURETY BOND GUARANTEE UNDERWRITING REVIEW

SURETY COMPANY: [illegible] Co

PRINCIPAL NAME: Newell A. Hardesty

SBA NO: 64227-10

APPLICANT'S TRADE NAME AND ADDRESS:
Builders United Construction Co.
P.O. Box 1109
Rogers, AR

Items 1-16 are to be completed on each bond Guarantee Submission to SBA, including the initial Submission and All Subsequent Submissions

### A. SURETY'S REVIEW

1. JOB DESCRIPTION AND LOCATION (Including Obligee): Obligee is Jacoway-Herdlinger construction of law offices

2. CONTRACT AMOUNT (Approx on Bid; Exact on Performance): 95,000

2(a) BOND $ OR %: 5%

3(a) PENALTY CLAUSE: ☐ YES ☒ NO

4. BOND NUMBER: [illegible]

5. IS PRESENT PROJECT SIMILAR TO PREVIOUS WORK PERFORMED? ☒ YES ☐ NO

6. WHEN DOES JOB BEGIN? notice to proceed

7. SCHEDULED COMPLETION DATE: not specified

8. HOW MUCH AND STATUS OF WORK IN PROGRESS?
140,000-15% 1340-75%
3969-30%
1000-50%

8(a) VERIFIED BY OBLIGEE(S): ☒ YES ☐ NO

8(b) HOW MANY? 1

8(c) OF HOW MANY? 1

8(d) HAS SURETY CHECKED WITH SUPPLIERS? ☒ YES ☐ NO

8(e) HOW MANY? 4

8(f) OF HOW MANY? 6

9(a) DATE OF FINANCIAL STATEMENT: 4/30/76 FY END

9(b) IS THERE SUFFICIENT WORKING CAPITAL? ☒ YES ☐ NO

10(a) FINAL (PAYMENT/PERFORMANCE) BOND SUB.? ☐ YES ☒ NO

10(b) WHAT IS BID SPREAD?

NOTE: If the review is for a bid bond request, the Surety must forward SBA a listing of the Bid Spread prior to Surety's issuance of the final bonds

11(a) SUBCONTRACTORS INVOLVED IN THIS JOB? ☐ YES ☒ NO

11(b) PARTICIPATION %

11(c) BONDED? ☐ YES ☐ NO

12. IS CONTRACT SBA 8(a)? ☐ YES ☒ NO

13(a) DOES CONTRACTOR REQUIRE FINANCIAL/MNGMNT/TECH ASSISTANCE? ☐ YES ☒ NO

13(b) IF YES WHAT TYPE?

14. REMARKS/CONCLUSIONS: Capable men started in business as of 3/75 and inc. in 7/75 and are doing well

15. CONTINUATION SHEET ATTACHED — CHECK (✓): ☐

16. SBA FORM 990 (Guarantee Agreement) ATTACHED — CHECK (✓): XXX

Items 17-25 are to be completed only on the initial submission and its Annual Up-Date

17. TYPE AND AMOUNT OF CONTRACTUAL WORK THIS CONTRACTOR HAS DONE PREVIOUSLY

18(a) LARGEST PREVIOUS CONTRACT: $

18(b) LARGEST PREVIOUS WORK PROGRAM: $

19(a) ANY DISPUTES? ☐ YES ☐ NO

19(b) ON SCHEDULE? ☐ YES ☐ NO

20(a) HAS CONTRACTOR EVER FAILED TO COMPLETE JOB? ☐ YES ☐ NO

20(b) DETAILS

21. WHAT IS EXPERIENCE(S) OF OFFICERS AND/OR OWNERS?

22(a) CONTRACTOR HAVE ADEQUATE EQUIP? ☐ YES ☐ NO

22(b) OWNED? ☐ YES ☐ NO

22(c) LEASED? ☐ YES ☐ NO

23. CONTRACTOR'S TAXES CURRENT? ☐ YES ☐ NO

24. CONTRACTOR INSURANCE COVERAGE SUFFICIENT? ☐ YES ☐ NO

25(a) SURETY RECEIVED COPY OF CURRENT FINANCIAL STATEMENT? ☐ YES ☐ NO

25(b) DATE OF FINANCIAL STATEMENT

25(c) PREPARED BY WHOM?

25(d) FINANCIAL STATEMENT SHOW DISCLAIMER? ☐ YES ☐ NO

25(e) TYPE OF FINANCIAL STATEMENT: ☐ CASH ☐ SIMPLE ACCRUAL ☐ COMPLETED CONTRACT ☐ % COMPLETION

25(f) NET WORTH: $

25(g) WOA

25(h) SURETY VERIFIED BANK BALANCE? ☐ YES ☐ NO

25(i) AVG BANK BALANCE: $

SBA Form 990B (1-73) REF SOP 50 45 PREVIOUS EDITIONS ARE OBSOLETE

CONTRACTOR HAVE BANK LINE OF CREDIT? ☐ YES ☐ NO
WITH WHOM?
HOW MUCH BANK LINE OF CREDIT?

VERIFICATION OF PAYABLES? ☐ YES ☐ NO
AGED? (# over 60 days)
HOW MANY?
OF HOW MANY?

VERIFICATION OF RECEIVABLES? ☐ YES ☐ NO
AGED? (# over 60 days)
HOW MANY?
OF HOW MANY?

ANY REMARKS FROM CREDITORS CONCERNING THIS CONTRACTOR

CONTRACTOR HAVE CURRENT SBA LOAN? ☐ YES ☐ NO
HOW MUCH & STATUS?
PREVIOUS SBA LOAN? ☐ YES ☐ NO
SBA LOAN APPLIC PENDING? ☐ YES ☐ NO

CONTRACTOR PREVIOUSLY BONDED? ☐ YES ☐ NO
AMOUNT $
WITH WHOM?

CONTRACTOR HAVE BONDING LINE? ☐ YES ☐ NO
AMOUNT $
PREVIOUS SBA BOND GUAR.? ☐ YES ☐ NO
AMOUNT & STATUS

In our opinion, the principal appears to have the financial/management/technical abilities necessary to successfully complete this contract, however, we feel this contractor falls below the normal underwriting standards of our company, and we cannot issue bonds to this contractor without the SBA Guarantee

UNDERWRITER
DATE

ADDRESS (Include Zip Code)
[illegible] ICA
[illegible] 214
TELEPHONE (Include A/C)

**8. SMALL BUSINESS ADMINISTRATION'S REVIEW**

1 SBG NO. (Give Suffix) 64227-10
REVIEW OF INITIAL SBAG? ☐ YES ☐ NO
SUBSEQUENT SBAG? ☐ YES ☐ NO
3 MEETS SIZE STANDARDS? ☐ YES ☐ NO

CONTRACTOR NEEDS FIN/MG/TECH ASSIST? ☐ YES ☐ NO
WHAT TYPE?
REQUEST OTHER SBA ASSIST (MD ETC.) ☐ YES ☐ NO
WHAT TYPE?

IF NECESSARY ASSISTANCE IS NOT READILY AVAILABLE IN GOVERNMENT, HAVE YOU REFERRED APPLICANT TO FUNDED ASSISTANCE PROGRAMS I.E., MINORITY CONTRACTORS ASSISTANCE PROGRAM (MCAP) ETC.?
(NAME ASSISTANCE)

BASED ON THE ABOVE THERE ☐ IS ☐ IS NOT REASON TO EXPECT SUCCESSFUL COMPLETION OF THE CONTRACT
THE COSTS ☐ DO ☐ DO NOT APPEAR TO BE REASONABLE

IT HAS BEEN DETERMINED THAT THE REQUESTED BOND(S) ☐ IS ☐ ARE NECESSARY AND THE SURETY COMPANY HAS INDICATED THAT IT WILL NOT ISSUE THE BOND(S) WITHOUT THE SBA GUARANTEE

REMARKS/CONCLUSIONS

W.C.H. 122 (Current F/S 4/30/76
Contract 95 (NOT in F/S)
Total 217 N W 14.4 M
— Loss w/c — Bank Ref good.
Exp good

9 ATTACHMENTS (Check Appropriate Box)
CONTINUATION SHEET ☐
SBA FORM 990 ☐
CONTRACTORS CURRENT FINANCIAL STATEMENT ☐
COPIES OF BONDS ☐
WE ARE IN RECEIPT OF SBA FORM 912 ☐ AND APPROPRIATE SBA FORM 994 FOR THIS CONTRACTOR AND JOB ☐

10 RECOMMENDATION ✓ APPROVAL ☐ DISAPPROVAL

REVIEWING OFFICIAL (Signature)
TITLE Surety Bond Assist.
DATE 8/5/76

APPROVING OFFICIAL (Signature) Fred Lawrence
TITLE Acting ARD/F&I
DATE 8-5-76

SBA Form 994B (2-73)

SMALL BUSINESS ADMINISTRATION

## GUARANTEE AGREEMENT UNDER TITLE IV, PART B, OF THE SMALL BUSINESS INVESTMENT ACT OF 1958, AS AMENDED

This agreement, made and entered into this 3rd day of August, 19 76,

by and between the Small Business Administration, an agency of the United States Government, hereinafter referred as SBA and

[illegible] Co., hereinafter referred to as Surety,

relative to Builders United Construction Co., hereinafter referred to as Principal,

who has applied for bonds required for construction of law offices for Jacoway-[illegible]
(describe project)

WITNESSETH: That in consideration of the mutual convenants and agreements herein contained, the parties agree as follows:

1. Surety agrees, conditional on the execution of this guarantee by SBA, to become surety on the bid bond and if Principal's bid price is in line with other bidders in Surety's opinion and the contract price does not exceed $500,000, to become surety on performance, payment, maintenance, or any other bonds necessary or incidental to the performance of the above described contract executed on behalf of the Principal. The agreement in this paragraph shall not apply unless all prescribed underwriting conditions are met, nor shall it apply if subsequent or additional information comes to the attention of the Surety of a nature to change its underwriting decision as to the desirability of executing any of the aforementioned bonds.

2. Surety represents that such bond or bonds when executed by it as to terms and conditions will be in accord with those executed by professional sureties for the type of contract for which such bond or bonds are required to be furnished by Principal.

3. Surety affirms that without this SBA guarantee to Surety it will not issue any of said bonds to Principal.

4. SBA hereby agrees to guarantee to Surety 90% of any "loss" Surety may sustain or incur in good faith by reason of its execution of the bid, payment or performance bond contemplated by this Agreement.

5. SBA agrees that the term "loss" as used in this Agreement shall mean any and all liability, damages, court costs, counsel fees, charges and expenses of whatever kind or nature which the Surety shall or may, at any time, sustain or incur by reason, or in consequence, of having executed the bond or bonds herein guaranteed by SBA.

6. The Surety shall be entitled to credit for any and all disbursements, in and about the matters herein contemplated, made by it in good faith under the belief that it is or was liable for the sums and amounts so disbursed, or that it was necessary or expedient to make such disbursement (including efforts to diminish "loss"), whether such liability, necessity or expediency existed or not, and vouchers or other evidence of such disbursement shall be taken as prima facie evidence against SBA of the fact and extent of SBA's liability to Surety.

7. SBA agrees that Surety shall be entitled to reimbursement on a calendar quarterly basis under this guarantee for its loss, adjusted pro rata for any payments received by Surety from any other source.

UNITED INSPECTION BUREAU, INC.
Insurance Adjusters

3550 Wilshire Boulevard
Los Angeles, Calif. 90010
(213) 386-2378

February 13, 1973

Chief Underwriter
Surety Bond Guarantee / Underwriting Division
SMALL BUSINESS ADMINISTRATION
1441 "L" N.W.
WASHINGTON, D.C. 20416
Att: Danny Gibb

WHEN REPLYING REFER TO:
SURETY: American Fidelity Fire Ins. Co. Clai
No. 841
BOND NUMBER: 04-446-2221850

Re: PRINCIPAL: BUILDERS UNITED CONSTRUCTION.
SBG NO: 64227 10

Dear Sir:

The above referred to Surety has been notified as follows:

XXX Demand upon the Surety by a payment bond claimant.

☐ Demand against the performance bond by the Obligee.

☐ Notification of potential payment bond claim.

☐ Notification from obligee that principal is experiencing financial difficulties, or has not been performing contract work satisfactorily, and that there is a possibility that the obligee may make a demand upon the performance bond in the future.

The purpose of this letter is merely to inform the Small Business Administration of information received by the Surety regarding the possibility of a claim or a potential claim against the captioned bond. This matter will be promptly investigated and upon completion of same, the Small Business Administration will be provided with a comprehensive report explaining whether it is anticipated that the above bond will incur a net loss.

Very truly yours,

Perry Lisker

Manager, Surety Bond Claims Department

cc: Mr. Jud Simpkins
Surety Bond Guarantee Officer
1720 Regal Row-Suite 230
Dallas, Texas 75235
cc: Home Office
cc: Attorney in fact.

[illegible] M624

3 p.

UNITED INSPECTION BUREAU, INC.
Insurance Adjusters

3550 Wilshire Boulevard
Los Angeles, Calif. 90010
(213) 386-2378

February 23, 1978

**WHEN REPLYING REFER TO:**
Bond No. 04-446-2221850

Mr. Dan Gibb, Chief Underwriter
Surety Bond Guarantee
Underwriting Division
Small Business Administration
1441 "L" Street N.W.
Washington, DC 20416

RE: Principal: Builders United Construction
Bond No.: 04-446-2221850
SBG No.: 6422740
American Fidelity Fire Insurance Company
Claim No.: 841125

Dear Mr. Gibb:

The following is pursuant to required notification procedures.

In this matter, the surety had issued a performance bond in the amount of $100,000.00. Difficulties arose in this project when the principal's president simply left the job after it was substantially completed.

The surety's attorney advises that claims in the amount of $24,469.79 have been presented. The surety's attorney has approved claims in the amount of $13,064.54 and has denied the remainder of the claims. The surety's attorney advises that the basis of this denial is a legal defense in that the bond which was issued guaranteed the faithful performance of the contract and no bond guaranteeing payment was ever issued. The attorney has taken the position that only those claimants who file liens against the owner, or obligee, are entitled to be paid under the terms of the performance bond. All of those claimants who have not filed liens have been denied.

The surety's attorney further advises that the owners are holding $7,440.73 which they have agreed to forward to the surety.

To date, the surety has paid a total of $13,064.54 in completion costs, attorney's fees and claim adjustment expenses. Please establish a reserve to cover this figure and an additional $1,000.00 to cover future attorney's fees and claim adjustment expenses. Should the status of this matter change, you will be advised and an appropriate reserve recommendation made.

The surety's attorney is currently investigating the possibility of indemnity recovery and you will be further updated in this regard.

Very cordially yours,

James A. Hillery

James A. Hillery,
Claims Attorney

JAH:mv

CC: American Fidelity Fire Insurance Company
Attorney-In-Face
SBA Regional Office

8. Surety agrees that if any suit or claim is brought or instituted against Surety upon said bond or bonds, Surety shall inform SBA of the same within a reasonable time of receipt of the summons and complaint or claim in the Surety's home office. Unless otherwise agreed, Surety shall take charge of all claim matters arising under said bonds, determine its liability and the amount thereof, compromise, settle or defend any claim or suit, and, take such action as it deems necessary to minimize loss.

9. Subsequent to the signing of the contract by the parties obligated thereon and the execution of the bonds guaranteed herein, no act or omission of the Surety in modifying amending, limiting or extending any instrument executed by the Surety, nor the execution of any consent to the contract or bond(s) herein referred to, shall in anywise affect the liability of SBA hereunder, nor shall SBA be released from this obligation by reason thereof; and it is further agreed that Surety may thereafter alter, change, modify, amend, limit or extend any instrument or may execute renewal thereof, or other and new obligations in its place or in lieu thereof without notice to SBA, and in such case SBA shall be liable to Surety as fully and to the same extent on account of any such altered, changed, modified, amended, limited or extended instrument or such renewals thereof, or other or new obligations in its place or in lieu thereof, as fully as if such instrument were described at length herein.

10. Surety agrees to pay SBA 10% of its bond(s) premium for and in consideration of SBA's agreement to guarantee the bid, payment or performance bond contemplated by this Agreement. It is further agreed by SBA and Surety that Surety will pay SBA an additional like percentage of the additional premiums collected on any increase in contract price and SBA will make a like percentage refund on any premium reductions resulting from a reduction in the contract price. Where SBA or Surety's share of any additional premium increase or decrease is Five Dollars ($5 00) or less, there shall be no adjustment.

IN WITNESS WHEREOF, the parties have caused this Agreement to be executed the date and year first above written.

American Fidelity Fire Insurance Co.
SURETY

By ____________________
Sam H. Less Attorney in Fact

SMALL BUSINESS ADMINISTRATION

By Lawrence 8-5-76
Acting ARD/PSI Date

Amount of Contract $ 95,000
Date [illegible]

Bond Amount: Bid 4,750 Performance ____________ Payment ____________
Date ____________
Premium Charged (and % Rate) 15.00 flat charge
Scheduled Contract Completion Date not specified SBG #64227-10

SBA FORM 990 (3-72) GPO 885-594

SMALL BUSINESS ADMINISTRATION

# APPLICATION FOR SURETY BOND GUARANTEE ASSISTANCE

4

NAME OF APPLICANT AND ITS PRINCIPAL
[illegible]

| | |
|---|---|
| APPLICANT'S HOME ADDRESS (Include ZIP)<br>Rogers Ark | APPLICANT'S BUSINESS ADDRESS (Include ZIP)<br>Rogers Ark |

NAME OF BROKER/AGENT

| | |
|---|---|
| BROKER/AGENT'S ADDRESS (Include ZIP) | BROKER/AGENT'S TELEPHONE (Include Area Code) |
| | NAME OF SURETY IF KNOWN |

1. Applicant hereby states and affirms the following:
   - a. The gross annual receipts of my business (including affiliates) during the past fiscal year was $ ________, or as annually averaged over the past 3 fiscal years (to the nearest hundreds) was $ ________.
   - b. A bid, payment or performance bond is required on the following project or to serve as a primary contractor or subcontractor thereon.
   - c. Contractor certifies having attempted (and failed) to obtain the required bonds without the SBA's guarantee, furthermore, the contractor certifies being aware that some sureties charge higher premium rates for bonds than others do.
   - d. Brief description of project including projected job completion date or, on prequalification, size of job and total work in progress you feel you can handle.
   - e. Approximate value of contract: $ [illegible].
   - f. Applicant, in consideration of assistance from the SBA herewith agrees that it will comply with the nondiscrimination requirements of Title 13, Code of Federal Regulations, Part 112 and Part 113.

2. The date, time and place of the bid opening is as follows: (if applicable):

| | | |
|---|---|---|
| Date 1/21/76 | Time 7:30 pm | Place [illegible] Ark |

3. I have read the "Contractor's Fee" section (reverse side) and agree to abide by this fee schedule, PROVIDED I receive the contract sought and SBA extends its bond guarantee. I also agree to pay the contractor's guarantee fee to my Agent/Broker at the time I receive the bond, in accordance with Paragraph 9, reverse side.

4. I presently ☑ do not have an SBA Loan ☐ previous loan or other program assistance
☐ do have an SBA Loan through the ________ office
with a balance of $ ________ as of (date) ________

5. I ☐ am ☐ am not an SBA 8(a) Qualified Contractor

This bond application ☐ does ☐ does not pertain to an 8(a) contract ☐ does ☐ does not pertain to SBG Bond Line of Credit

☑ have received previous SBA bond guarantee(s) ☐ have not received previous SBA bond guarantee(s)

If you have received previous SBA bond guarantee(s), have you ever defaulted on any of them? (Either under this contracting concern's trade name or any other concern's of which you have been a principal ☐ Yes ☒ No

If "yes", detailed particulars are to be attached to all four(4) copies of this application form. Particulars should include at least the following: (1) Name of Surety; (2) Name of Obligee; (3) SBG #w/Suffix Number; (4) Value of Contract, (5) Date of Default; (6) Status of Default/ Claim, i.e., amount of loss to Surety, etc.; (7) Contractor's narrative explanation as to reason for default and actions taken to meet the obligations to the Surety under terms of the bond(s..

6. Applicant hereby authorizes any agent, broker or surety company in possession of credit, financial or work experience information concerning the undersigned applicant and the applicant's business to release the same to SBA, in order that SBA may evaluate the same for the purpose of bond guarantee assistance.

Applicant certifies that any information he submits to any agent, broker or surety company for their evaluation as to the bondability of this contractor is correct and accurate to the best of the contractor's knowledge.

7. Any intentionally false statement in this application or willful misrepresentation relative thereto is a violation of federal law, which may subject you to criminal and civil prosecution, 18 U.S.C. Sections 287,371,1001, 15 U.S.C. Sections 645, 31 U.S.C. Section 231, carrying fines up to $10,000 and imprisonment up to five years."

I hereby certify that all information presented herein is complete and accurate to the best of my knowledge.

| | |
|---|---|
| SIGNATURE (Applicant)<br>Newell C. [illegible] | Executed this date<br>1/13/76 |

SBA Form 994 (10-74) REF: SOP 50 45 PREVIOUS EDITIONS ARE OBSOLETE

SBG-11(6)1227-11

WHITE COPY - SBA REGIONAL OFFICE
YELLOW COPY - SBA DISTRICT OFFICE
PINK COPY - SURETY
GOLDENROD COPY - PRODUCER (AGENT/BROKER)

## SURETY BOND GUARANTEE OPERATING PROCEDURES

1. Applicant contacts nearest SBA office which would furnish him the following:
   a. Four copies of SBA Form 994, Application for Surety Bond Guarantee Assistance, from SBA.
   b. SBA Form 912, Statement of Personal History, on first application only, or as required.
2. Applicant proceeds to the surety agent of his choice and furnishes that agent with the following:
   a. Credit information and work experience history normally required by surety underwriters.
   b. Four copies of completed SBA Form 994.
   c. Completed SBA Form 912, on first application only, or as required.
3. Surety agent will forward the original of the SBA Form 994, and the SBA Form 912 (all copies), directly to: Small Business Administration, Surety Bond Guarantee, Regional City SBA Office.
4. Surety agent will forward a copy of the completed SBA Form 994 to the nearest SBA office.
5. Agent will forward to surety company:
   a. A duplicate copy of the SBA Form 994, keeping fourth copy for his own records.
   b. All other information normally required by surety company to underwrite a bond applicant.
6. Assuming favorable decision to proceed by the underwriters, the surety will forward a summary of underwriting information and a signed and completed SBA Form 990, Guarantee Agreement, for the case in hand directly to the Small Business Administration, Surety Bond Guarantee, Regional City SBA Office.
7. **The SBA's Surety Bond Guarantee underwriting review staff will make final determinations as required. Within three (but no more than five days) of receipt of summary underwriting information from the surety, SBA will notify the surety of approval (or disapproval) and return the countersigned Guarantee Agreement to the surety. For those contracts or projects valued at more than $500,000, the SBA field office's SBG underwriting review staff will make recommendations to the Washington Central office's SBG staff for disposition. This procedure will require allowing an extra 10 days of SBA processing time.**
8. Assuming the applicant is low bidder, and before entering into a contract to perform the work, applicant will return to the agent to request payment and performance bonds as required.
9. Agent will notify the applicant that upon presentation of the bonds, the applicant will present a check payable to the SBA for the guarantee fee. Agent is to receive the contractor's guarantee fee (as explained below) from applicant prior to issuing the necessary bonds to the contractor. The surety agent will forward the fee directly to the Small Business Administration, Surety Bond Guarantee, Regional City SBA Office.

## CONTRACTOR'S FEE

The guarantee fee is .2% ($2 per $1000) of contract's face value, or, in the case of partial bonds, either .2% of the contract's face value or 20% of the premium charged by the Surety, whichever is less. **All contractor guarantee fees are due and payable upon receipt of bonds.**

SMALL BUSINESS ADMINISTRATION

## SURETY BOND GUARANTEE UNDERWRITING REVIEW

| | |
|---|---|
| SURETY COMPANY<br>American Fidelity Fire Insurance Co. | APPLICANT'S TRADE NAME AND ADDRESS<br>Builders United Construction Co.<br>P. O. Box 1109<br>Rogers, Arkansas |
| PRINCIPAL NAME<br>Newell Hardesty | |
| SBG NO.<br>64227-14 | |

Items 1-16 are to be completed on each bond Guarantee Submission to SBA, including the initial Submission and All Subsequent Submissions

A. SURETY'S REVIEW

1. JOB DESCRIPTION AND LOCATION (Including Obligee)

Obligee is United Luthern Church - Bella Vista, Arkansas
Construction of new church - Job #7524-A

| | | | |
|---|---|---|---|
| 2. CONTRACT AMOUNT Approx on Bid; Exact on Performance<br>120,000 | 3(a) BOND $ OR %<br>.5% | 3(b) PENALTY CLAUSE<br>☒ YES ☐ NO | 4. BOND NUMBER<br>2221704-AH |
| 5. IS PRESENT PROJECT SIMILAR TO PREVIOUS WORK PERFORMED?<br>☐ YES ☐ NO | | 6. WHEN DOES JOB BEGIN?<br>Notice to proceed | 7. SCHEDULED COMPLETION DATE<br>To be bid |

8. HOW MUCH AND STATUS OF WORK IN PROGRESS?

100,000 - 25%

| | | | |
|---|---|---|---|
| 8(a) VERIFIED BY OBLIGEE(S)<br>☒ YES ☐ NO | 8(b) HOW MANY?<br>1 | 8(c) OF HOW MANY?<br>1 | |
| 9(a) HAS SURETY CHECKED WITH SUPPLIERS?<br>☒ YES ☐ NO | 9(b) HOW MANY?<br>4 | 9(c) OF HOW MANY?<br>6 | |
| 9(d) DATE OF FINANCIAL STATEMENT<br>4/30/76 FY End | 9(e) IS THERE SUFFICIENT WORKING CAPITAL?<br>☒ YES ☐ NO | 10(a) FINAL (PAYMENT/PERFORMANCE) BOND BID?<br>☐ YES ☐ NO | 10(b) WHAT IS BID SPREAD? |

NOTE: If this review is for a bid bond request, the Surety must forward SBA a listing of the Bid Spread prior to Surety's issuance of the final bond.

| | | |
|---|---|---|
| 11(a) SUBCONTRACTORS INVOLVED IN THIS JOB?<br>☒ YES ☐ NO | 11(b) PARTICIPATION %<br>35% | 11(c) BONDED?<br>☒ YES ☐ NO |
| 12. IS CONTRACT SBA 8(a)?<br>☐ YES ☒ NO | 13(a) DOES CONTRACTOR REQUIRE FINANCIAL/MNGMNT/TECH ASSISTANCE?<br>☐ YES ☒ NO | 13(b) IF YES WHAT TYPE? |

14. REMARKS/CONCLUSIONS

Capable ment started business as of 3/75 and inc. in 7/75 and are doing well.

| | | | |
|---|---|---|---|
| 15. CONTINUATION SHEET ATTACHED | CHECK (✓) | 16. SBA FORM 990 (Guarantee Agreement) ATTACHED. | CHECK (✓)<br>X |

Items 17-35 are to be completed only on the initial submission and its Annual Up-Date

17. TYPE AND AMOUNT OF CONTRACTUAL WORK THIS CONTRACTOR HAS DONE PREVIOUSLY

| | | | |
|---|---|---|---|
| 18(a) LARGEST PREVIOUS CONTRACT<br>$ | 18(b) LARGEST PREVIOUS WORK PROGRAM<br>$ | 19(a) ANY DISPUTES?<br>☐ YES ☐ NO | 19(b) ON SCHEDULE?<br>☐ YES ☐ NO |
| 20(a) HAS CONTRACTOR EVER FAILED TO COMPLETE JOB?<br>☐ YES ☐ NO | 20(b) DETAILS | | |

21. WHAT IS EXPERIENCE(S) OF OFFICERS AND/OR OWNERS?

| | | | |
|---|---|---|---|
| 22(a) CONTRACTOR HAVE ADEQUATE EQUIP?<br>☐ YES ☐ NO | 22(b) OWNED?<br>☐ YES ☐ NO | 22(c) LEASED?<br>☐ YES ☐ NO | 23 CONTRACTOR'S TAXES CURRENT?<br>☐ YES ☐ NO |
| 24. CONTRACTOR INSURANCE COVERAGE SUFFICIENT?<br>☐ YES ☐ NO | 25(a) SURETY RECEIVED COPY OF CURRENT FINANCIAL STATEMENT?<br>☐ YES ☐ NO | 25(b) DATE OF FINANCIAL STATEMENT | 25(c) PREPARED BY WHOM? |
| 25(d) FINANCIAL STATEMENT SHOW DISCLAIMER?<br>☐ YES ☐ NO | 25(e) TYPE OF FINANCIAL STATEMENT<br>☐ CASH ☐ SIMPLE ACCRUAL ☐ COMPLETED CONTRACT ☐ % COMPLETION | | |
| 25(f) NET WORTH<br>$ | 25(g) WCA | 26(a) SURETY VERIFIED BANK BALANCE?<br>☐ YES ☐ NO | 26(b) AVG BANK BALANCE<br>$ |

SBA Form 994B (2-73) REF SOP 50 45 PREVIOUS EDITIONS ARE OBSOLETE

27(a) CONTRACTOR HAVE BANK LINE OF CREDIT? ☐ YES ☐ NO
27(b) WITH WHOM?
27(c) HOW MUCH BANK LINE OF CREDIT?

28(a) VERIFICATION OF PAYABLES? ☐ YES ☐ NO
28(b) AGED? (% over 60 days)
28(c) HOW MANY?
28(d) OF HOW MANY?

29(a) VERIFICATION OF RECEIVABLES? ☐ YES ☐ NO
29(b) AGED? (% over 60 days)
29(c) HOW MANY?
29(d) OF HOW MANY?

30. ANY REMARKS FROM CREDITORS CONCERNING THIS CONTRACTOR

31(a) CONTRACTOR HAVE CURRENT SBA LOAN? ☐ YES ☐ NO
31(b) HOW MUCH & STATUS?
32(a) PREVIOUS SBA LOAN? ☐ YES ☐ NO
32(b) SBA LOAN APPLIC. PENDING? ☐ YES ☐ NO

33(a) CONTRACTOR PREVIOUSLY BONDED? ☐ YES ☐ NO
33(b) AMOUNT $
33(c) WITH WHOM?

34(a) CONTRACTOR HAVE BONDING LINE? ☐ YES ☐ NO
34(b) AMOUNT $
35(a) PREVIOUS SBA BOND GUAR.? ☐ YES ☐ NO
35(b) AMOUNT & STATUS

In our opinion, the principal appears to have the financial/management/technical abilities necessary to successfully complete this contract; however, we feel this contractor falls below the normal underwriting standards of our company, and we cannot issue bonds to this contractor without the SBA Guarantee.

UNDERWRITER SURETY CORP. OF AMERICA
DATE 10/13/76

ADDRESS (Include Zip Code)
1420 Union Ave. - Suite 214
Memphis, Tenn. 38104

TELEPHONE (Include A/C)
NEW PHONE NUMBER
(901) 726-6461

**B. SMALL BUSINESS ADMINISTRATION'S REVIEW**

1. SBD NO. (With Suffix) 64227-14
2(a) REVIEW OF INITIAL 994B? ☐ YES ☑ NO
2(b) SUBSEQUENT 994B? ☑ YES ☐ NO
3. MEETS SIZE STANDARDS? ☑ YES ☐ NO

4(a) CONTRACTOR NEEDS FIN/MGT/TECH ASSIST.? ☐ YES ☑ NO
4(b) WHAT TYPE?
5(a) REQUEST OTHER SBA ASSIST MAO ETC.? ☐ YES ☑ NO
5(b) WHAT TYPE?

6. IF NECESSARY ASSISTANCE IS NOT READILY AVAILABLE IN GOVERNMENT, HAVE YOU REFERRED APPLICANT TO FUNDED ASSISTANCE PROGRAMS I.E., MINORITY CONTRACTORS ASSISTANCE PROGRAM (MCAP) ETC.?
(NAME ASSISTANCE):

7(a) BASED ON THE ABOVE THERE ☑ IS ☐ IS NOT REASON TO EXPECT SUCCESSFUL COMPLETION OF THE CONTRACT
7(b) THE COSTS ☑ DO ☐ DO NOT APPEAR TO BE REASONABLE
7(c) IT HAS BEEN DETERMINED THAT THE REQUESTED BOND(S) ☑ IS ☐ ARE NECESSARY AND THE SURETY COMPANY HAS INDICATED THAT IT WILL NOT ISSUE THE BOND(S) WITHOUT THE SBA GUARANTEE

8. REMARKS/CONCLUSIONS
4145,0cc W.c.H. #14. 4 NC.

9. ATTACHMENTS (Check Appropriate Box)
9(a) CONTINUATION SHEET ☐
9(b) SBA FORM 990 ☑
9(c) CONTRACTORS CURRENT FINANCIAL STATEMENT ☐
9(d) COPIES OF BONDS ☐
9(e) WE ARE IN RECEIPT OF SBA FORM 912 ☑ AND APPROPRIATE SBA FORM 994 FOR THIS CONTRACTOR AND JOB. ☐

10. RECOMMENDATION ☑ APPROVAL ☐ DISAPPROVAL

REVIEWING OFFICIAL (Signature)
TITLE Surety Bond Assist.
DATE 10-19-76

APPROVING OFFICIAL (Signature)
TITLE Acting ARD/F&I
DATE 10/29/76

SBA Form 994B (3-73)

SMALL BUSINESS ADMINISTRATION

## GUARANTEE AGREEMENT UNDER TITLE IV, PART B, OF THE SMALL BUSINESS INVESTMENT ACT OF 1958, AS AMENDED

This agreement, made and entered into this 18th day of October, 1976,

by and between the Small Business Administration, an agency of the United States Government, hereinafter referred as SBA and

American Fidelity Fire Insurance Co., hereinafter referred to as Surety,

relative to Builders United Construction Company, hereinafter referred to as Principal,

who has applied for bonds required for Construction of new church - Job #7524-A -
(describe project)
United Luthern Church - Bella Vista, Arkansas.

WITNESSETH: That in consideration of the mutual convenants and agreements herein contained, the parties agree as follows:

1. Surety agrees, conditional on the execution of this guarantee by SBA, to become surety on the bid bond and if Principal's bid price is in line with other bidders in Surety's opinion and the contract price does not exceed $500,000, to become surety on performance, payment, maintenance, or any other bonds necessary or incidental to the performance of the above described contract executed on behalf of the Principal. The agreement in this paragraph shall not apply unless all prescribed underwriting conditions are met, nor shall it apply if subsequent or additional information comes to the attention of the Surety of a nature to change its underwriting decision as to the desirability of executing any of the aforementioned bonds.

2. Surety represents that such bond or bonds when executed by it as to terms and conditions will be in accord with those executed by professional sureties for the type of contract for which such bond or bonds are required to be furnished by Principal.

3. Surety affirms that without this SBA guarantee to Surety it will not issue any of said bonds to Principal.

4. SBA hereby agrees to guarantee to Surety 90% of any "loss" Surety may sustain or incur in good faith by reason of its execution of the bid, payment or performance bond contemplated by this Agreement.

5. SBA agrees that the term "loss" as used in this Agreement shall mean any and all liability, damages, court costs, counsel fees, charges and expenses of whatever kind or nature which the Surety shall or may, at any time, sustain or incur by reason, or in consequence, of having executed the bond or bonds herein guaranteed by SBA.

6. The Surety shall be entitled to credit for any and all disbursements, in and about the matters herein contemplated, made by it in good faith under the belief that it is or was liable for the sums and amounts so disbursed, or that it was necessary or expedient to make such disbursement (including efforts to diminish "loss"), whether such liability, necessity or expediency existed or not, and vouchers or other evidence of such disbursement shall be taken as prima facie evidence against SBA of the fact and extent of SBA's liability to Surety.

7. SBA agrees that Surety shall be entitled to reimbursement on a calendar quarterly basis under this guarantee for its loss, adjusted pro rata for any payments received by Surety from any other source.

8. Surety agrees that if any suit or claim is brought or instituted against Surety upon said bond or bonds, Surety shall inform SBA of the same within a reasonable time of receipt of the summons and complaint or claim in the Surety's home office. Unless otherwise agreed, Surety shall take charge of all claim matters arising under said bonds: determine its liability and the amount thereof; compromise, settle or defend any claim or suit; and, take such action as it deems necessary to minimize loss.

9. Subsequent to the signing of the contract by the parties obligated thereon and the execution of the bonds guaranteed herein, no act or omission of the Surety in modifying, amending, limiting or extending any instrument executed by the Surety, nor the execution of any consent to the contract or bond(s) herein referred to, shall in anywise affect the liability of SBA hereunder, nor shall SBA be released from this obligation by reason thereof; and it is further agreed that Surety may thereafter alter, change, modify, amend, limit or extend any instrument or may execute renewal thereof, or other and new obligations in its place or in lieu thereof without notice to SBA, and in such case SBA shall be liable to Surety as fully and to the same extent on account of any such altered, changed, modified, amended, limited or extended instrument or such renewals thereof, or other or new obligations in its place or in lieu thereof, as fully as if such instrument were described at length herein.

10. Surety agrees to pay SBA 10% of its bond(s) premium for and in consideration of SBA's agreement to guarantee the bid, payment or performance bond contemplated by this Agreement. It is further agreed by SBA and Surety that Surety will pay SBA an additional like percentage of the additional premiums collected on any increase in contract price and SBA will make a like percentage refund on any premium reductions resulting from a reduction in the contract price. Where SBA or Surety's share of any additional premium increase or decrease is Five Dollars ($5.00) or less, there shall be no adjustment.

IN WITNESS WHEREOF, the parties have caused this Agreement to be executed the date and year first above written.

American Fidelity Fire Insurance Co.
SURETY
By Sam H Less
Sam H. Less - Attorney-in-Fact

SMALL BUSINESS ADMINISTRATION
By 10/19/76
Acting ARD/F&I
Date

---

Amount of Contract $ 120,000
Date 10/21/76

Bond Amount: Bid. 6,000 Performance ____ Payment ____
Date ____ ____
Premium Charged (and % Rate) $15.00 Flat Charge
Scheduled Contract Completion Date To be bid

SBG #64227-14

SBA FORM 990 (3-72)

GPO [illegible]

UNITED INSPECTION BUREAU, INC.
Insurance Adjusters

3550 Wilshire Boulevard
Los Angeles, Calif. 90010
(213) 386-2378

**WHEN REPLYING REFER TO:**

October 25, 1977

Mr. Dann Gibb, Chief Underwriter
Surety Bond Guarantee Underwriting Division
Small Business Administration
1441 "L" Street, N. W.
Washington, D. C. 20416

Re: Builders United Construction Company
Bond No.: 04-446-2221945
SBG No.: 64227-14

Dear Mr. Gibb:

The following is pursuant to required notification procedures.

The principal defaulted on this project because of it's financial difficulties when the job was approximately 50 to 60% completed. The Surety, through it's attorney, has arranged for completion of the project by another contractor. Arrangements are now being finalized with the completion contractor.

It appears that the costs to complete the project are in the amount of approximately $93,700.00.

It appears that there are pending labor and material payment bond claims in the amount of approximately $30,000.00. The Surety's attorney is continuing to investigate the matter of pending claims, and you will be up-dated as more information develops.

There are remaining contract funds available to offset the Surety's losses in the amount of $74,000.00. The Surety's attorney will arrange to have these remaining funds assigned directly to the completing contractor by the obligee, so as to be a direct offset to the Surety's losses.

Please set up a reserve at this time of $50,000.00. Should the status of this matter change, you will be advised and an appropriate reserve recommendation made.

The Surety's attorney is also investigating the possibility of indemnity recovery, and you will be further up-dated in this regard.

Very truly yours,

Perry Lisker, Manager
rety Bond Claims Dept.

AFF cc: Attorney in fact cc: SBA Regional Office

UNITED INSPECTION BUREAU, INC.
Insurance Adjusters

3550 Wilshire Boulevard
Los Angeles, Calif. 90010
(213) 386-2378

9/13/77

WHEN REPLYING REFER TO:

SURETY: AFFI

BOND NUMBER 04-446-2221945

Chief Underwriter
Surety Bond Guarantee / Underwriting Division
SMALL BUSINESS ADMINISTRATION
1441 "L" N.W.
WASHINGTON, D.C. 20416

ATT: Danny Gibb

Re: PRINCIPAL Builders United Construction Co.
SBG NO. 64227-14

Dear Mr. Gibb

The above referred to Surety has been notified as follows:

☑ Demand upon the Surety by a payment bond claimant.

☐ Demand against the performance bond by the Obligee.

☐ Notification of potential payment bond claim.

☐ Notification from obligee that principal is experiencing financial difficulties, or has not been performing contract work satisfactorily, and that there is a possibility that the obligee may make a demand upon the performance bond in the future.

The purpose of this letter is merely to inform the Small Business Administration of information received by the Surety regarding the possibility of a claim or a potential claim against the captioned bond. This matter will be promptly investigated and upon completion of same, the Small Business Administration will be provided with a comprehensive report explaining whether it is anticipated that the above bond will incur a net loss.

Very truly yours,

Perry Lisker

Manager, Surety Bond Claims Department

D.I.
D.C.
Mr. Jed Simpkins
Surety Bond Guarantee Officer
SBA
1720 Regal Row-Suite 230
Dallas, Texas 75235

cc Attorney in Fact

WRIGHT, LINDSEY & JENNINGS
ATTORNEYS AT LAW
2200 WORTHEN BANK BUILDING
LITTLE ROCK, ARKANSAS 72201

501 371-0808

EDWARD [illegible]RIGHT
[illegible]
ROBERT S. LINDSEY
ALSTON JENNINGS
RONALD A. MAY
JAMES D. STOREY
GEORGE E. LUSK, JR.
WINSLOW DRUMMOND
W. J. WILLIAMS, JR.
PHILIP S. ANDERSON
EDWARD L. WRIGHT, JR.
ISAAC A. SCOTT, JR.
JAMES M. MOODY
ROBERT D. CABE
GUS B. WALTON, JR.
GORDON S. RATHER, JR.
TERRY L. MATHEWS
WILLIAM O. HAUGHT
DAVID M. POWELL

H. WILLIAM ALLEN
ROGER A. GLASGOW
C. DOUGLAS BUFORD, JR.
PAT GOSS
PETER G. KUMPE
DAVID F. MENZ
ALSTON JENNINGS, JR.
JOHN R. TISDALE
KATHLYN GRAVES
M. SAMUEL JONES, III
ANNABELLE CLINTON
JOHN WILLIAM SPIVEY, III
SUSAN FOX MARTIN
LEE J. MULDROW
CHARLES L. SCHLUMBERGER
WENDELL L. GRIFFEN
BONNIE R. MACDOUGAL
EDGAR J. TYLER

S. ONE
JUN 23 1980

6

June 19, 1980

Re: Bond No. : 04-447-2221945
Principal : Builders United Construction Co.
Project : United Lutheran Church

Bond No. : 04-447-2221850
Principal : Builders United Construction Co.
Project : Jacoway & Herdlinger Law Offices

Mr. Jim Hillary
United Inspection Bureau, Inc.
15910 Ventura Boulevard
Encino, California 91436

Dear Mr. Hillary:

This is to report on developments in the suit we filed on behalf of American Fidelity against the individual indemnitors on the above bonds, Terry and Sandra Hardesty, Larry and Louise McGarrah and Ray and Carol Rogers.

① Counsel for the Rogers' and the McGarrah's filed a motion for summary judgment on the theory that the bonds were procured through an agent (one James Canfield) who was not registered with the State Insurance Commission as an agent of American Fidelity as required by statute. I have now received a letter from the trial judge, copy enclosed, indicating that he is granting the relief requested. I also enclose xerox copies of the statutes on which the decision is based.

② Unfortunately, the defendants are correct that agent Canfield was not, at the time, properly registered with the State Insurance Commission. In addition, the bonds were not countersigned by a resident agent in Arkansas.

I did a good deal of research on this matter in opposition to the motion and I have now read the cases cited by the trial judge in his letter. I simply find no case whatsoever directly in point. There appears to be no Arkansas case in which an insurance contract was declared "void" on the basis of the above statute. None of the cases cited by the trial judge deal with a situation like this but rather with non-insurance contracts which were prohibited by various other statutes.

Of course, our position was that the insurance company's obligations under the bond were long since discharged, that the defendants did not have standing to raise the statutory issue, that they were beneficiaries under the bonds, and so on. Apparently, the trial judge has simply rejected these arguments and held that an indemnity agreement is void when applied to a bond procured by an unlicensed agent.

I have discussed this situation at some length with Mr. Mike Less in Memphis and he very naturally inquired as to the possibilities of reversing the trial judge on appeal. Our court of appeals is unpredictable at best and I am having a good deal of trouble evaluating our chances due to the novelity of the issues and the complete lack of relevant case law. After a good deal of thought, and discussion with other attorneys in the office, I have come to the conclusion that, as a practical matter, our chances of reversing the trial judge are less than 50/50. Our court of appeals has a strong tendency to defer to the trial judge's judgment and I think they would have a tendency to rely on the plain language of the statute in this case rather than doing an in-depth analysis of the legal issues in order to reverse.

I should mention that we will have problems in this case even if we are successful in having the summary judgment reversed. The case will be vigorously defended before a local jury and the "hometown" factor is substantial in the corner of the state where the case would be tried. The defendants are described to me as day laborers who will certainly claim that they had no real involvement in the management of the company, no understanding of bonds or indemnity agreements, etc. In Rogers' case, he is contending that defendant Hardesty forged his signature. Hardesty, who actually ran the business, is out of the jurisdiction of the court and cannot be located. There is no way around the fact that a jury is simply going to be reluctant to bring in a large verdict against these people.

Judgment has not yet been entered and we will have thirty days from the date of entry within which to appeal. After you have had an opportunity to digest all of the above, please let me know and we can discuss it in more detail.

Very truly yours,

WRIGHT, LINDSEY & JENNINGS

Original Signed
ALSTON JENNINGS, JR.
Alston Jennings, Jr.

AJJ/ch
cc: Mr. Perry Lisker
Mr. Mike Less

NINETEENTH JUDICIAL CIRCUIT
BENTON COUNTY COURTHOUSE
BENTONVILLE, ARKANSAS 72712

W. H. ENFIELD
CIRCUIT JUDGE
P. O. BOX [illegible]
TELEPHONE [illegible]

COUNTIES:
BENTON
CARROLL
MADISON

June 17, 1980

Mr. Barry J. Watkins
Attorney
Box 296
Springdale, AR 72764

Re: Benton #CIV-78-255
American Fidelity Fire Ins.
Co. vs. Builders United Constr.
et al

Dear Mr. Watkins:

Plaintiff is a foreign insurance corporation which wrote performance bonds for Builders United Construction, Inc., and incurred expenses in performing the contractors obligations after the latter's default on two jobs. Defendants are sued as indemnitors under the terms of a "General Contract of Indemnity."

Defendants contend that the contract is void and unenforceable, because Plaintiff did not comply with Ark. Stats., sec. 66-2222, requiring that all policies of surety insurance issued by an authorized insurer and covering a subject of insurance located in this state shall be countersigned by a licensed agent, resident in this state. Ark. Stats., sec. 66-2221 prohibits the issuance of such policies unless by and through an agent, resident in this state, of the insurer duly licensed as such agent.

The parties do not dispute that the policies in this case were sold to the contractor by Jim Canfield, who was not licensed as an agent for Plaintiff with the Insurance department. Nor is there any question that the policies were not countersigned by a resident licensed agent of Plaintiff. The sole question is whether under these circumstances the General Indemnity Contract executed in support of the Plaintiff's performance bonds is illegal and void.

The Arkansas Supreme Court has repeatedly held that contracts in violation of a statute are void, even though the statute does not expressly declare them void; and where a statute prohibits the doing of a certain act under penalty, an agreement founded on the prohibited act is ordinarily void. Gantt v. A P & L Co., 189 Ark 449; Randle v. Interstate Grocer Co., 147 Ark 402; Security Mutual Life Ins. Co. v. Little, 119 Ark 498; Tate v. Gould, 175 Ark 306; 17 C.J.S., Contracts, sec. 201.

In their briefs, Defendants state that they were not in the corporation (Builders United) at the time the performance bonds were issued. Although this fact remains disputed, it is of no consequence. When faced with an illegal contract, the court will leave the parties where it found them and will not lend the authority of the law to enforcement of the contract or recovery from the consequences thereof.

It follows that Defendants' motions for summary judgment must be sustained. Mr. Watkins will prepare and submit to the Court a precedent for judgment in line with this opinion.

Very truly yours,

W. H. Enfield

W. H. ENFIELD

WHE: lj

CC: Mr. Alston Jennings, Jr. ✓
Mr. Erwin L. Davis
Mrs. Josephine Heyland

for each day of delinquency, such penalty to be collected by the Commissioner, if necessary, by a civil suit therefor brought by the Commissioner in the Circuit Court of Pulaski County, unless the penalty is waived by the Commissioner upon a showing by the insurer of good cause for its failure to file its report on or before the date due.

(6) At time of filing, the insurer shall pay the fee for filing its annual statement as prescribed by section 68 [§ 66-2301].

(7) In addition to information called for and furnished in connection with its annual statement, an insurer shall furnish to the Commissioner as soon as reasonably possible such information with respect to any of its transactions or affairs as the Commissioner may from time to time request in writing. [Acts 1959, No. 148, § 62, p. 418.]

**Section to Section Reference.**

This section is referred to in § 66-2213.

**66-2221. Resident agent required.** — (1) Subject to section 65 [§ 66-2223], no authorized insurer shall issue a policy or binder as to a subject of insurance resident, located, or to be performed in Arkansas, unless by and through an agent, resident in this State, of the insurer duly licensed as such agent under this code.

(2) With respect to those surety bonds as referred to in section 11-604 of Arkansas Statutes, 1947 Annotated, such a resident agent shall execute such bond, and shall be entitled to the full commission paid local agents. The mere countersigning of the bond by the agent shall not be sufficient.

(3) The Commissioner may revoke the certificate of authority of any insurer which he finds has violated this section. [Acts 1959, No. 148, § 63, p. 418.]

**Section to Section Reference.**

This section is referred to in § 66-2223.

**66-2222. Countersignature law — Property, surety and casualty policies.** — (1) Except as stated in section 65 [§ 66-2223] all policies of property, surety, and casualty insurance issued by an authorized insurer and covering a subject of insurance located or to be located in this State, shall be countersigned by a licensed agent, resident in this State, of the insurer, which agent shall receive and retain as commission five per cent (5%) of the premium or fifty per cent (50%) of the agent's commission on the policy, whichever is the lesser.

(2) If a policy is countersigned by a representative of the insurer other than a resident agent, as provided for in subsection (1), above, the insurer shall furnish the resident agent receiving the commission thereon with a complete and detailed record of such policy, which shall become a part of the records of the resident agent.

(3) As to policies covering property or risks located in more than one state the insurer may, in its discretion, use a countersignature indorsement thereon showing the policy to which attached and information in respect to such policy, including full premium information, sufficient for the countersigning agent's records. The indorsement shall be signed by the countersigning agent in lieu of countersignature of the original policy.

(4) No countersigning resident agent shall countersign a policy or countersignature indorsement in blank. [Acts 1959, No. 148, § 64, p. 418; 1965, No. 89, § 1, p. 254.]

**Amendment.**

The 1965 amendment substituted "to be located" for "to be performed" near the beginning of the section and substituted the words "which agent shall receive and retain as commission five per cent (5%) of the premium or fifty per cent (50%) of the agent's commission on the policy, whichever is the lesser" for the words "which agent shall receive and retain the usual commission paid by the insurer; except, that in lieu of countersignature by such an agent, such a policy may be countersigned by the insurer's executive officer, general agent, state agent, special agent or other supervising agent or officer if the usual commission on such policy is paid by the insurer to a licensed resident agent of the insurer as defined in section 146" at the end of subsection (1).

**66-2223. Exceptions to resident agent and countersignature law—Property, surety and casualty policies.**—The provisions of section 63 [§ 66-2221] and 64 [§ 66-2222] shall not apply to:

(1) Life insurance and annuities.

(2) Disability insurance.

(3) Title insurance.

(4) Reinsurance contracts between insurers.

(5) Reciprocal insurers.

(6) Policies issued by mutual insurers not customarily using commission agents, and on which no commission is payable to any local agent.

(7) Insurance of oil, gasoline and similar products, and property used in the production, manufacture and sale thereof.

(8) Insurance of the rolling stock, vessels or aircraft of any common carrier in interstate or foreign commerce, or of any vehicle principally garaged and used in another state, or covering any liability or other risks incident to the ownership, maintenance or operation thereof.

(9) Insurance of property received for shipment or delivery, or in transit, while in the possession and custody of railroad companies or other common carriers.

(10) Wet marine and foreign trade insurance.

(11) Bid bonds issued by any surety insurer in connection with any public or private contract. [Acts 1959, No. 148, § 65, p. 418; 1963, No. 138, § 1, p. 379.]

**Amendment.**

The 1963 amendment added subsection (11).

**Repealing Clause.**

Section 2 of Acts 1963, No. 138 repealed all laws and parts of laws in conflict therewith.

**Section to Section Reference.**

This section is referred to in § 66-2221.

**66-2224. Countersignature law—Group life and group disability policies—Penalty.**—(1) Hereafter, all policies or contracts of group life or group health and accident insurance, except contracts of reinsurance between companies, on persons in this State, shall be countersigned by a resident agent who shall receive and retain one-half [½] the usual commission paid by the insurer. Provided, that such policy or contract may be countersigned by an executive officer, general agent, state agent, special agent, or other supervising officer of such company who is duly licensed by the Insurance Commissioner to represent such company if one-half [½] the usual commission on such policy is paid by the company to a resident agent. Resident agents receiving a commission on any policy countersigned by a company representative other than a resident agent shall be furnished by the company with a complete detailed record of all such policies on which he receives a commission, and shall keep a record thereof; provided further, that nothing in this

The **Chairman**. Our first witness is the Inspector General of the Small Business Administration, Mr. Paul Boucher.

Mr. Boucher, if you will step forward? And we will receive your statement in its entirety into the record, and you proceed in any way that you deem fit.

## STATEMENT OF PAUL R. BOUCHER, INSPECTOR GENERAL, SMALL BUSINESS ADMINISTRATION

Mr. **Boucher**. Mr. Chairman, I do have a prepared statement, which I'd like to read, at least in part, and I think I will be able to summarize portions of it to save the committee's time.

Mr. Chairman, this is the second time in less than 2 years I have appeared before this committee to testify on the state of the Small Business Administration's surety bond guarantee program.

As you will recall, your committee staff and the Office of Inspector General of SBA worked closely to develop information which was brought out in the first hearings held in September 1980. That effort resulted in the disclosure that certain individuals known to be involved in or associated with organized crime in Chicago, Ill., had participated in the surety bond guarantee program.

Unfortunately, today I will again have to inform the committee that our audit efforts have disclosed the involvement of yet another organized crime associate in the surety bond guarantee program.

At your last hearing, we also reported that the Office of Inspector General had ongoing a number of activities covering the surety bond guarantee program. At your request, I am prepared to provide you with a more in-depth assessment of the program based on the results of this and other efforts.

Initially, let me state that the concern demonstrated by you, Mr. Chairman, and by the committee, as exemplified by its vigorous oversight of the surety bond guarantee program operations, is fully warranted. The surety bond guarantee program is an important one. It is a program which has performed and can continue to provide a valuable service to small business by making available to it opportunities which could not otherwise exist without the backing of the Federal Government.

It is noteworthy that since its implementation in September 1971, this program has provided bond guarantees on more than 142,000 contracts in bond amounts approximating $10.7 billion. On the other side of the ledger, during this same time more than 8,000 contracts have gone into default, which have resulted in net claims payments by SBA to participating sureties of about $178 million.

In terms of its day-to-day direction and control, the program can be described as one in which SBA historically has delegated virtually all discretion to surety companies and their agents. In many respects, our participating sureties have conducted themselves in a responsible and professional manner and appear to have served well the interests of small business and the taxpayer. It is my understanding that you will hear from representatives from some of these companies today.

Unfortunately, and for reasons with which the committee is familiar, SBA's own management shortcomings, as well as the actions of some of our participating sureties and their agents, give cause for considerable concern about the state of the program.

With respect to our participating sureties, I must emphasize that our primary concern relates only to a relatively few surety companies which are called "specialty companies," apparently because they specialize in and to a significant extent subsist on the business they write in the surety bond guarantee program.

Unfortunately, however, it is those few specialty companies which have written the lion's share of the bonds, and with which this committee and the Office of Inspector General have the greatest concern.

First of all, and by way of explanation, let me discuss generally how a surety bond transaction might occur.

A small business person is presented with an opportunity to perform on a contract. One element of the process requires that the contractor be bonded. An approach by the small business person to an underwriter discloses the underwriter's reluctance to provide a bond in the absence of an SBA guarantee. SBA is approached by the parties and agrees to guarantee the bond.

In most cases, the SBA agrees to guarantee 90 percent of any losses incurred by the surety company represented by the underwriter, in return for 20 percent of the bond premium. Upon default, claims attorneys or claims adjusters for the surety company select a contractor to complete the unfinished project. The claims adjusters or claims attorneys subsequently bill the SBA, through the participating surety, for costs incurred as a result of the default.

While the entire process may appear to be straightforward in the rather basic manner outlined, I think the results of the audit and investigative work of the Office of Inspector General and other organizations since the program's inception in September 1971 will serve to illustrate the problems still facing the program after more than 10 years of operation.

By way of background, in February 1973 and August 1974, SBA auditors conducted a preliminary review of the surety bond guarantee program. Their reports noted the absence of review and oversight of underwriting activities on the part of surety company agents, and the lack of policies and procedures required of underwriters in processing claims on defaulted contracts. Program officials agreed on the need for policy guidance in both areas to insure the program was being operated efficiently and effectively.

In June 1975, a second review of the surety bond guarantee program disclosed the continuing absence of any underwriting guidelines for participating sureties against which their underwriting activities could be evaluated and monitored by SBA program personnel.

Program officials agreed with the auditors once again that these guidelines were needed. In effect, after 4 years of operation, SBA still had issued no underwriting guidelines for use by program participants, knew little, if anything, about the claims processing functions of the participants, and had taken virtually no steps to bring about uniformity and control over the program.

The results of these shortcomings were predictable. In 1977 the Office of Inspector General undertook a limited review of claims filed with SBA to uncover evidence of fraud, mismanagement or other indications of program weaknesses. The review covered claims filed by the American Fidelity Fire Insurance Co., which I'll refer to as AFF, of New York, and the International Fidelity Insurance Co. of Newark, N.J., which I'll refer to as IFI. At that time, AFF was the single largest participant in the surety bond guarantee program with approximately 45 percent of the surety bond volume.

Based on available data, these two sureties alone have accounted for nearly 44 percent of all claims filed to date on bonds written prior to January 1, 1979. Translated into dollars, of the $129 million thus far paid by SBA on bonds written up to that date—that's January 1, 1979—these two sureties have received $56 million, or 43 percent of the dollars paid on these claims.

Following the review of 31 claims under AFF and IFI, auditors cited the following exceptions:

Inadequate underwriting procedures in 29 of the 31 claims.

Eligibility or justification for SBA guarantees was questioned in 21 of the 31 claims.

Failure to provide timely notice of default in 11 claims.

The reimbursement by SBA of questionable administrative costs in 11 claims.

Incomplete or inadequate accounting for contract recoveries in 13 claims.

Violations of U.S. Treasury underwriting limitations in 11 claims.

Fraud or material alterations of underwriting conditions in six claims.

These findings were presented to the program officials, causing some dismay. Our activities apparently caused some concern within AFF as well, a concern which manifested itself in a legal challenge by AFF to our very authority to conduct routine examinations of its records and those of its agent.

As a result of an opinion from the SBA Office of General Counsel that the AFF challenge did have a valid basis in law, the Office of Inspector General was forced to curtail its audit activity in January of 1978. In October 1978, the Small Business Act was amended to clarify the authority of SBA to conduct routine examinations.

Mr. Chairman, I would note that while AFF's challenge to our authority did have a basis in law, it would now appear that their refusal might well have been motivated more by our audit findings, and the possibility that they might be used as a basis for SBA's denial of liability on some of their claims, than their real desire to vindicate a technical legal principle.

In December of 1979, the General Accounting Office, GAO, conducted a review of the surety bond guarantee program, noting the lack of underwriting guidelines, the absence of systems or procedures for claims processing, and the lack of incentives on the part of sureties to mitigate losses, the same findings that had been made in the past.

During the spring of 1980, the Office of Inspector General again focused its attention on the program. As I noted at the outset, a joint effort by the Office of Inspector General and the committee staff yielded evidence of involvement by organized crime figures in Chicago, Ill.

At a hearing in September of 1980, Mr. Chairman, the committee heard evidence that Irwin Weiner, an organized crime associate who was unproductively subpenaed before the committee, was an agent for IFI and had underwritten a number of bonds guaranteed by SBA.

Other persons involved with Weiner known to have organized crime connections were Joseph Cosentino, William Ballay, Mitchell Caplan, and Mitchell and Marshall Caifano. I would note that in 1980, both Mr. Cosentino and Mr. Ballay applied for authority to participate in the surety bond guarantee program. That's after your September hearings. Mr. Cosentino's request was denied. Mr. Ballay's is still pending a decision from SBA.

Our investigations of the activities of Weiner and his associates were referred to the Department of Justice, due to the existence of possible fraud in a number of transactions involving these individuals and their companies.

At about the same time these hearings took place, the Inspector General's Office had undertaken or was in the process of initiating a three-part effort related to various aspects of the surety bond guarantee program.

I'd like to outline these efforts, if I could, Mr. Chairman.

One phase of this effort involved the further review of a number of large claims which had been paid by SBA for the purpose of determining the existence of fraud or other improprieties connected with these transactions. To this end, we conducted audits of 14 claims submitted to SBA by 4 different sureties: The Balboa, IFI, Heritage, and Dependable Insurance companies. Payments made by SBA on these 14 contract claims alone totaled just under $3 million.

Evidence of possible fraud sufficient to warrant referral to the Department of Justice was discovered in 3 of the 14 claims audited. SBA payments made in these three claims alone totaled about $650,000.

As a result of evidence developed in just one of these audits, a Federal Grand Jury in Chicago, Ill., recently returned a 20-count indictment against Chicago attorney Melvin Dick and State Construction Co. president, Anthony Giacomino.

Since this matter is now pending prosecution with the Department of Justice, I will limit my comments on this case. I can advise the committee that the facts upon which the referral to the U.S. attorney's office was predicated related to a $2.5 million construction contract awarded to the Bergen Construction Co. by the city of Chicago.

In October 1976, Bergen subcontracted with Minority Builders, Inc., to perform concrete work valued at $213,500. Minority Builders subsequently defaulted on its contract, and Heritage Insurance, a coinsurer with AFF on the concrete subcontract, referred the default to Melvin Dick, a claims attorney. Based on Mr. Dick's estimates of the cost of completion, Heritage issued a $196,000 contract to State Construction Co.—Mr. Giacomino. At the time of this transaction, the city of Chicago itself had estimated that only about $25,000 would be required to fully complete the subcontract.

Rather than do the concrete work itself, State Construction subcontracted the entire concrete completion project to another company for $88,650. The pending Federal indictment against Dick and Giacomino alleges various counts of fraud and mail fraud associated with the more than $100,000 difference between what State received and what it paid to its subcontractor to complete this work.

With respect to the defendants in this case, Mr. Chairman, the records of the Chicago Crime Commission reflect that Mr. Giacomino is regarded to be a known associate of organized crime figures in the Chicago area. He was indicted in January 1980 on Federal charges of receiving stolen property and conspiracy relating to his involvement in snow removal contracts in the Chicago area.

In connection with that case, he was served with a subpena calling for the production of records located in a mobile home owned by him. Prior to the return date on the subpena, the mobile home suffered an explosion which destroyed evidence of value to the case. That prosecution ended in a mistrial, and his retrial is pending.

With respect to the destruction of evidence, Mr. Giacomino was indicted on charges of mail fraud, obstruction of justice, and destruction of property by explosives. He was recently convicted and sentenced to 7 years in the custody of the Attorney General as a result of that particular case.

Given the background of Mr. Giacomino, I think it's ironic that the subcontract which formed the basis for his recent Federal indictment was for work that he was to perform on a new police station for the city of Chicago.

Melvin Dick has no known prior association with Mr. Giacomino. He formerly served as a claims attorney for IFI in the Chicago area. His only known connection with individuals of interest to this committee relates to the fact that as part of his professional responsibilities, he had processed a number of contract default claims for the bonding agency headed by Irwin Weiner.

A second phase of this project resulted in an internal audit report issued by the Office of Inspector General in April 1981, and the committee has a copy of that, Mr. Chairman.

Some of the findings of this audit were not surprising. In 1981, we reported there were still no underwriting standards which had been developed, just as reported by the GAO nearly 2 years earlier; no claims processing procedures, no definitions of reimbursable losses had been developed and implemented, as was reported in 1974; and there existed an absence of any incentives on the part of sureties to minimize losses.

I won't go into a detailed discussion since the findings in this report form the basis for a number of recommendations later in my testimony.

Our third and final effort in the surety bond guarantee program brings us back to AFF of New York. You will recall, Mr. Chairman, that we had terminated our audit work in 1978 because of their refusal to cooperate with SBA. As a result of questions later raised concerning the financial viability of AFF, the Inspector General's Office requested the assistance of the New York State Insurance Commission in a mutual effort to review AFF, the Market Insurance Co. of California, its managing agent, and the United Inspections Bureau of California, its claims agent.

I would like to take this opportunity to publicly commend the New York State Insurance Commission for its assistance in this matter. I think this represents a fine example of excellent Federal-State cooperation on a matter of mutual concern.

As a result of this activity, the following observations were made by the New York State Insurance Commission and the Office of Inspector General:

As part of the audit, the book balances of AFF and SBA on 52 claims were selected for confirmation by the New York State officials. Due to the inadequacy of both UIB's reporting of claims information and SBA's handling of information received, 42 of the 52 claims could not be reconciled to balances on AFF's books.

UIB did not submit required 6-month status reports and invoices in a timely manner. As a result, the lack of managerial control in dealing with this function had significantly weakened internal controls and resulted in inadequate claims handling systems.

Attempts to develop information on status reports and other claims documentation were difficult, if not impossible in some cases, due to the poor state of records within SBA. In approximately 80 percent of the claims reviewed, the SBA could provide no evidence of having received a status report on a default within 1 year of its occurrence.

Balances due and owing to SBA were not being remitted by AFF on a timely basis. In one 2-month period in 1980, AFF remitted $1 million in refunds to SBA after this situation was called to its attention.

New York State authorities consistently found that the reporting of reserve requirements by AFF was not done on a timely basis and, when reported, were underestimated. As a result, they estimate that reserve losses by SBA are also believed to be underestimated.

A review of 200 claims files substantiated earlier GAO and SBA findings that necessary information for the issuance of these bonds by the underwriter, and meaningful review by SBA, was either missing or incomplete and that no underwriting standards were in effect.

The results of this joint undertaking only served to further underscore the chaotic state of SBA's surety bond guarantee program, both from the standpoint of SBA's control of its own activities and the absence of management and control by AFF and its affiliates.

Having discussed the significant problems in the program, Mr. Chairman, the next question would seem to be: Where do we go from here?

Before I attempt to offer some suggestions, however, I think that something must be considered as part of any attempt to assess how we got to where we are today. In my view, an analysis as to some of the causes of the problems associated with the surety bond guarantee program must begin with a review of the operations of SBA as an agency over the years.

I think there can be no doubt that in the last 10 to 15 years, major changes in the nature, scope and breadth of the mission and responsibilities of the SBA have occurred. Not only have program delivery programs expanded considerably but, at the same time, SBA has been required to take on a number of new responsibilities.

By way of illustration, during the 10-year period between 1970 and 1980, SBA's loan portfolio has grown from $2 billion to $17 billion. 8(a) contract awards have gone from 400 in 1970 to nearly 5,000 in 1980. There has been the development of the Small Business Institute and Small Business Development Center programs; the nonbank lender, certified lenter and 503 local development company programs have been instituted; a significant growth in the small business investment company program, the creation of a vital advocacy function, and involvement in an expanded disaster loan program to meet the needs of farmers. During the same 10-year period, Mr. Chairman, SBA also took on the surety bond guarantee program. In effect, we have seen a tremendous growth in the activities and influence of the SBA, all of which have been resource consuming.

When we consider the fact that, with all these added commitments, SBA had more full-time personnel in 1970 than it does today, is it really a shock that some programs have not been afforded the type of management attention necessary to avoid waste, fraud, abuse, and mismanagement.

This is not meant to suggest that by merely throwing more people into a program, we will necessarily achieve better program performance. By the same token, any effort to achieve effective management of an ever-burgeoning workload calling for the development of expertise and sophistication in a number of areas at a time when resources remain constant or are shrinking is an open invitation to some of the problems we have seen.

Mr. Chairman, I think some of the problems we see today—not all of them—can be traced to some extent to a shortage of competent, well-trained personnel during the planning, development and implementation stages and an over-delegation of discretion to sureties, which in some cases has worked to our detriment.

To this day, the program has only one employee with any previous surety bond experience. As examples of what we have seen in SBA generally and in this program specifically, I would ask the committee to consider the following facts:

At the end of fiscal year 1972, SBA had written 1,339 contract bonds, having a value of $94 million. The program had 36 people assigned to it.

During fiscal year 1981 alone, nearly 18,000 contract bonds carrying guarantees totaling $1.6 billion had been written. At that time, there were a total of 51 program personnel, 17 of whom were part-time employees. In effect, the program has experienced a 15-fold increase in bonding activity and a commensurate increase in default related claims activity, while gaining only 15 people.

Over an 11-year history, more than 8,000 bonds have gone into default and claims payments on a little over 7,000 have exceeded $178 million. These claims have been processed by a central office staff which has had to rely, to a significant extent, on part-time claims processors.

At the present time, the Central Office claims review staff consists of 18 personnel, including 5 of whom are part-time college students with absolutely no claims experience, processing and paying millions of dollars in claims each year. They pay on an honor system, with no questions asked, and the sureties know that the chances of a spot check by SBA are virtually nonexistent.

When these factors are noted, Mr. Chairman, and then we consider the management record of the program, one cannot help but conclude that the SBA just does not have the present ability to provide good quality service to the small business community.

I think the surety bond guarantee program is a perfect example of what can occur when adequate, competent, and well-trained staffing is not made available.

It seems we have come to the point where some difficult decisions will have to be made about SBA's priorities for the future. We must decide what programs and services are essential to small business and realign existing resources to conform to these decisions. Such decisions may well involve legislative action. Where appropriate, SBA should consider delegating to or contracting with the private sector to expand its involvement in areas designed to aid small business. Undoubtedly, any effort to consolidate and realign will require some innovative and creative approaches to getting the job done.

Let me review, if I could, Mr. Chairman, some of the things I think ought to be considered by SBA's management team in an effort to try to turn around the surety bond guarantee program. I will just summarize some of these things in the interest of time.

My first recommendation is one which has been made over the years: Something has to be done about underwriting, coming up with standards which our participants can know what's expected of them, know the types of bonds which ought to be underwritten, and have an audit trail for SBA to follow.

I don't think, to this point, SBA has developed a profile of the claims verification and processing systems used by its sureties and underwriters. I think a review of these procedures and the development of some uniform process for the handling of claims, the documentation required on claims, and a definition of those charges which SBA is going to pay is essential. Based on our audit experience, we have real concern about the nature and scope of legal and other fees which can be charged to SBA as a reasonable cost to the contract.

At the present time, some sureties have virtually no risk of loss in this program. In many cases, even their 10 percent of the loss on a default is passed back to its agents.

We recommend consideration of some form of a sliding scale of guarantee fees based on loss rates, or some other creative structuring of the relationships to better protect the interests of SBA sureties and small business.

One of the things that has been a real problem to us, Mr. Chairman, and I think your staff will verify this, is the problems we encountered in trying to come up with information upon which to make some assessments of the program.

There are presently 26 separate computer reports relating to the surety bond guarantee program. The program officials themselves have said they're virtually useless to them. Our experience with them would cause us to take no exception with that particular statement. Until recently, when an OIG investigator manually reviewed numerous items of information, neither the OIG nor program officials had any real gauge of the default experience of various sureties, their average claims size, the amount of recoveries, etc. Such information is so vital to basic program monitoring that it should be automated and maintained for regular use by program officials. I think you can't even begin to manage a program unless you have a way to gather, evaluate and retrieve information on program experience. I think that's one of the things that has to be done in that program.

In connection with any effort to evaluate the program, one of the recommendations made by this office relates to the manner in which SBA has traditionally computed its loss rates in the surety bond guarantee program.

In all candor, I have to say that we encountered considerable resistance from the program officials when we suggested that they ought to compute their loss rates using a formula roughly equivalent to that used by the private sector or standard sureties to determine what their loss ratios were.

SBA over the years has measured its loss rate by taking the total amount of bonds written and comparing that to the amount of money paid out on those bonds. The surety industry, however, does it on the basis of premiums received as against defaults paid on.

I am informed that a 40 percent, or a 40-cent-on-the-dollar payout rate is considered acceptable by the standard sureties. The problem we see is that with SBA's program and the way we have been viewing it, we didn't have a way to measure our program performance in a manner comparable to the private sector.

If we used a formula roughly equivalent to that for SBA's entire program, we have computed, based upon information available, that we would be paying out in the program $2 for every $1 we take in, or a 200-percent loss rate in SBA's program.

I would hasten to add, I don't know whether that's good or bad in terms of the program itself, when one looks at the types of people we're helping and the types of contracts we're underwriting. What I am saying is: How can we get some measure of the quality of the sureties we are working with unless we know their record and our record in this program?

I think the program officials are moving toward developing a formula which will allow them to compare their experience with private sector sureties.

I think the surety bond guarantee program is much akin to a cost reimbursable contract. I think you will recall, Mr. Chairman, we've had hearings on our contracting problems at SBA in the past, where we noted that regular claims reviews by program officials coupled with audits of cost reimbursable contracts are really important in order to determine whether we're being overbilled. I think the same applies to the surety bond guarantee program. I think we have to do some claims adjusting, some spot checking, and we must have auditors out there as a deterrent in the future to any conduct of the nature we've discussed today.

Mr. Chairman, I've endeavored to highlight only a few of the more significant recommendations we would offer for the consideration of program managers and individuals more expert on the issues of suretyship than those of us in the Office of Inspector General.

What is clear to me, as it is to any other Federal and State audit organization which has examined the program, is that it cannot continue to operate without substantial changes. If the future management and direction of the program is not taken seriously, if a commitment is not made to address some of the serious deficiencies noted as a result of considerable audit efforts, I'm confident that we would report the very same findings to this committee in years ahead, and that this statement would probably be exhibit 1 to any testimony I might give in the years ahead.

I think we know what the program's problems are today, and I'm hopeful that SBA can and will do something about them. In terms of doing something about them, Mr. Chairman, I would again like to acknowledge the vital role played by this committee and its staff in the identification and resolution of problems of mutual concern in the surety bond guarantee program.

The cooperation and support of you, the committee and its staff in this regard has been and will continue to be greatly appreciated. In that spirit of cooperation, I'm hopeful that SBA, the committee, and my office can begin to make significant progress toward accomplishment of some of the improvements we need in this program.

That does conclude my prepared statement, Mr. CHAIRMAN.

The CHAIRMAN. Thank you very much, Mr. Boucher.

I'd like to discuss a few of the audits and investigations conducted by your office. I understand your office investigated a completion contract involving Jace Industries of New York. What were your findings?

Mr. BOUCHER. Mr. Chairman, in May of 1976, IFI issued an SBA-guaranteed bond to the Wilson Iron Works on a contract it had obtained to repair a wooden bridge for the town or the city of Duxbury, Mass. The contract was valued at approximately $208,000. As a result of Wilson's marginal experience in such work, the company underbid the contract and defaulted in September 1976. On default, the work was largely completed, and there was about $30,000 in contract funds still outstanding; that is, $180,000 of the original $208,000 had already been expended on the bridge repair.

IFI, through its claims attorney, selected Jace Industries to complete the bridge work. On March 22, 1977, IFI issued a contract to Jace for $135,000. On March 16, 1977, 1 week prior to receiving the contract from IFI, Jace subcontracted with the Long Island Dock Co. to complete the project for $84,000. You'll note the difference between $84,000 and $135,000.

Repairs to the bridge were completed in August of 1977. The total cost to complete the repair work was $403,711, on an original contract of $208,470. SBA paid $372,306 on this contract.

Our audit disclosed that Jace billed IFI for payments to the Bob Cris Corp., which was falsely represented to IFI to be the completion contractor, not the Long Island Dock Co.

Bob Cris Corp. itself was determined to have been created by the principals of Jace. The principals of Bob Cris were listed in the maiden names of their wives. The post office box address and telephone number listed for the Cris Co. belonged to an employee of Jace.

In spite of the foregoing, one of the officers of Jace denied any connection with the Bob Cris Corp.

IFI payments to Jace and Bob Cris for work allegedly done on the bridge contract totaled $112,000. In effect, Long Island Dock could have and basically did complete all the work itself. At the most, Jace functioned only as an unnecessary broker, and Bob Cris did absolutely nothing to further purposes of the contract.

Of the $112,000 paid to these two companies, SBA's share would have been about $100,000 for what it amounted to a brokerage charge.

I would note, Mr. Chairman, this case has been referred to the U.S. attorney's office in Brooklyn and is now under investigation by the FBI.

The CHAIRMAN. In other words, Cris and/or Jace were paid a total of $112,000 and did absolutely no work, except for whatever paperwork went forward to SBA?

Mr. BOUCHER. They processed a few vouchers and paperwork and visited the jobsite a few times and got $112,000.

The CHAIRMAN. And who is the surety?

Mr. BOUCHER. IFI.

The CHAIRMAN. This is IFI. The town of Duxbury approved a change order for new decking at $150 per 1,000 board feet for the completion contract, yet when Jace Industries billed the surety for the same decking, they charged $4,500 per 1,000 board feet. Was there any indication that this increase was justified? (See exhibit I beginning at p. 453.)

Mr. BOUCHER. We have no indication of that, Mr. Chairman, whatsoever.

The CHAIRMAN. Well, isn't that just outright fraud?

Mr. BOUCHER. You've raised the amount of money from $150 per board foot to $4,500. It is outright fraud, I would suggest.

The CHAIRMAN. Now, do you have any indication as to whether SBA tried to verify any of these costs?

Mr. BOUCHER. No, sir, they did not.

The CHAIRMAN. What were your audit findings in the *State Mechanical* case?

Mr. BOUCHER. Mr. Chairman, this bond goes back to 1974. It does take a while, as you will note, for some of these bonds to go into default. That's why the writing of the bond is sometimes many years prior to the actual default.

But in this case, SBA guaranteed a bond again executed by IFI, for State Mechanical Construction Co. to perform heating, ventilation and air conditioning work in the Public Safety Building in Newburgh, N.Y. In January 1976, the city declared State Mechanical Construction Co. in default. IFI retained a claims attorney, Mr. David Samson, to oversee the completion of the job.

Mr. Samson executed an oral contract with Progress Builders in May 1976 to complete the work for $198,000. Progress did little, if any, substantive work on the project itself, and was described in Dun & Bradstreet, as a matter of fact, as a general contractor having two to four employees, which subcontracted all work to others.

Not surprisingly, Progress subcontracted with two other companies to complete the work. One of the companies receiving a

$25,000 contract was owned by the brother of the president of Progress.

Our audit disclosed what appears to be that Progress received in excess of $46,000 for acting as nothing more than a broker on this particular contract.

I would note that IFI filed suit under its general indemnity agreement and was awarded $50,000, but the whereabouts of the principals of State Mechanical are unknown to this day.

SBA payments on this claim totaled $190,000. Again, it appears, Mr. Chairman, that we paid more than $46,000 for somebody to serve as a middleman.

The CHAIRMAN. My staff contacted Favino Mechanical Construction Co., the subcontractor on this project. According to Favino, Progress Builders, the completion contractor, did no physical work on this contract, yet the surety paid Progress or individuals close to that company a profit of approximately $71,000. This case is similar to the *Jace Industries* case, in that a broker subcontracted all the work to another party, did nothing on the job, and made a tidy profit.

I have a copy of a letter from the claims attorney on this case, David Samson, to the surety, IFI, in which Samson states, and I quote: "We have not reviewed the specifics of the claims involved, nor have we made any independent determination as to their respective merit." Although there was no verification of the claims, payment was recommended and paid by the Small Business Administration, and yet from the letter we know the claims attorney did not verify costs. Did the surety company or SBA attempt to document these costs in any other way? (See exhibit II beginning at p. 457.)

Mr. BOUCHER. Not to my knowledge, sir.

The CHAIRMAN. Now, this is the same surety company, IFI, which was involved in the *Jace* case. Furthermore, IFI is the same company that was involved with Irwin Weiner, the organized crime figure you discovered had infiltrated the surety bond guarantee program at this committee's 1980 oversight hearings.

Now, it seems to me that there comes to view a very clear picture of the way IFI runs its business, and I suppose I'd like to hear your comments in that regard.

Mr. BOUCHER. Well, Mr. Chairman, I think the facts do speak for themselves in many of these cases.

The CHAIRMAN. Yes.

Mr. BOUCHER. And I would suggest that there is room for considerable concern about IFI.

The CHAIRMAN. Well, does IFI still do business with SBA?

Mr. BOUCHER. To my knowledge, they do, sir.

The CHAIRMAN. And what were your findings in regard to the Mountain Enterprises audit?

Mr. BOUCHER. Mountain Enterprises basically involved SBA's guarantee of four bonds written during the period May through October 1978. These bonds were written between Mountain Enterprises and the various military services for the painting of buildings on two military bases in southern California.

In May 1979 the owner of Mountain, Mr. William Wyatt, walked off the jobs and was declared in default. At the time, only one contract had been completed. The contracts originally entered into totaled $401,513 for painting these buildings.

The United Inspection Bureau—that is, the claims attorneys, claims organization for AFF, which wrote this particular bond—arranged for completion of the contract.

Our findings in this case reflect, Mr. Chairman, a good example of sloppy underwriting. To obtain these bonds, Wyatt had submitted financial statements to Market Insurance, the underwriter, which purported to show a net worth of $653,000. Approximately $465,000 of this amount was listed in the form of 13 homes which Mr. Wyatt claimed to own in the El Centro, Calif., area.

The agent recalls that Mr. Wyatt even claimed that his assessed value—the assessed value of the homes was closer to $565,000, and that he was being conservative in his estimate on the value of these homes.

The agent for Market, our underwriter—AFF's underwriter, I'm sorry—took no steps to verify his ownership interest in any of these properties. Upon default, a review of appropriate records subsequent to that default disclosed that Wyatt had no property in southern California, and that Mountain Enterprises owned only two vacant lots in California valued at $520 each.

To date SBA, UIB, and the FBI have been unable to locate Mr. Wyatt. SBA has paid out to date $117,865, and I would suggest there's virtually no hope of any recovery on any of these contracts, since the property pledged was never there.

The CHAIRMAN. Did SBA make any attempt to verify this security?

Mr. BOUCHER. No, sir, they did not, but I'm not so sure they were in a position at the time to verify it. They accepted what Market gave them. That's one of the problems.

The CHAIRMAN. And what do we know, or what do you know, by virtue of your investigations as to Market's verification process?

Mr. BOUCHER. Well, Market relied totally on the underwriter, basically. Some information was verified, as I understand, but the big ticket items were never looked at.

The CHAIRMAN. The underwriter in this case being?

Mr. BOUCHER. Market is the underwriter, and the Clark-Levitt Agency is Market's agent out in the field.

The CHAIRMAN. And neither one——

Mr. BOUCHER. Nor the other, no, sir.

The CHAIRMAN. Neither one nor the other made any attempts to verify this information.

Discuss your findings in the *Western Environmental* case.

Mr. BOUCHER. In June 1976, SBA guaranteed a bond issued by AFF to the Western Environmental Co. for contract work to develop a recreation park for the county of Los Angeles. The bond ran for 1 year, and the contract value was $490,785.

On January 5, 1977, SBA was notified of Western's default. At that time, Western had claims against it from suppliers amounting to more than $300,000. AFF settled these claims for $35,000. The total cost to SBA to date, including legal fees, has been $100,400.

What we found here, Mr. Chairman, is an apparent scheme to circumvent the SBA rules prohibiting the bonding of owner/builder companies. The facts here are that in April and May 1976, Mr.

Bryan, the president of V.J.R.S. Co., tried to obtain a bond for his own company to construct the park, but was turned down by a private surety company, as well as AFF.

Apparently to overcome the problem, Bryan again approached Market Insurance with a contract between V.J.R.S. and Western dated April 1976. The facts, to get to the bottom line, disclose that the contract was a sham designed to overcome the owner/builder prohibition.

Bryan and V.J.R.S. were always in control of the contract. They controlled all disbursements, authorized all purchase orders.

Of 47 companies or individuals contacted in connection with this contract, only 5 even knew the president of Western Environmental. In fact, only 2 days after the bond was approved, Mr. Bryan removed Western's president from the job and placed his own personnel on Western's payroll.

Investigation also disclosed underwriting deficiencies on the part of AFF and its agent. For example, in response to a question about prior arrests other than for motor vehicle violations, the principal of Western said, "Yes, I have been arrested." Nobody asked him what it was for or what this background was, just a yes answer.

Further, Market or AFF did not analyze the principals' financial statements.

The CHAIRMAN. What had he been arrested for?

Mr. BOUCHER. I'm sorry you asked me that. I don't have that answer.

The CHAIRMAN. Is the answer anywhere in any records?

Mr. BOUCHER. We can get it, sir.

The CHAIRMAN. Just so that we complete the record on this, I think we'd better have the answer.

[Subsequent information was received and follows:]

**U.S. Small Business Administration**
Washington, D.C. 20416

OFFICE OF THE
INSPECTOR GENERAL

MAR 30 1982

Honorable Lowell P. Weicker
Chairman, Senate Select Committee
on Small Business
United States Senate
Washington, D.C. 20510

Dear Mr. Chairman:

Pursuant to your request at the Senate Committee on Small Business Hearing on March 11, 1982, regarding a reported arrest of Rex Edward Melton, Jr., d/b/a Western Environmental Landscape Systems, the following information is furnished.

On April 20, 1974, the Sheriff's Department of Los Angeles, California, arrested Rex Edward Melton, Jr., Date of Birth: November 30, 1948, on the charge of Planting, Cultivating, etc., of Marijuana, a violation of the Health and Safety Law of the State of California 11357. The charge was dismissed on an unknown date prior to 1976.

This information was furnished to the Small Business Administration on January 23, 1976, by the Federal Bureau of Investigation upon a normal submission request by the Surety Bond Guarantee Office for a character and suitability check.

Upon receipt of the above-cited information, a clearance was forwarded to the requesting Surety Bond Office (California), as this information would not make the individual ineligible for a surety bond.

Sincerely,

Paul R. Boucher
Paul R. Boucher
Inspector General

Mr. **Boucher**. Further, Market and AFF did not analyze the principals' financial statements, did not evaluate contract costs and work history, did not require copies of the contractor's tax returns. SBA's surety bond guarantee agreement, as I understand it, requires that sureties do all those things performed by professional sureties.

These items, or many of the items that I've outlined that we found Market had not done are required by professional sureties. So we didn't even follow the basic rules followed by most surety companies in protecting their interests in writing these bonds.

As I understand it, Mr. Bryan's whereabouts have been unknown since about August 1981.

The **Chairman**. Would you discuss your findings in the *Spight Landscaping* case?

Mr. **Boucher**. Well, the claims paid to date, Mr. Chairman, are only about $28,000, relatively small compared to some of the other claims we've seen. I think it's another example of why sound underwriting is so critical to the process.

The Spight Co. had received an SBA-guaranteed bond in 1976 and defaulted in 1977. SBA's policy is that we won't bond contractors with a default record, unless they repay all claims associated with the prior default.

The surety in this case was AFF. Its claims agent, UIB, recommended that SBA reinstate Spight on the basis of a repayment agreement executed by Spight. This agreement was secured by property located in the New Orleans area. The agreement was substantially flawed, however, Mr. Chairman, since Mr. Spight either did not own the property he had pledged as collateral, or he had recorded judgments filed on them already which were far above their book value.

Again, UIB took no steps to verify the ownership interests claimed by Spight before writing the bond.

In any event, SBA accepted the recommendation, we reinstated Spight, and subsequently guaranteed two bonds related to contracts to be performed for the Louisiana Highway Department. Mr. Spight or the Spight Landscape Co. defaulted on these projects in August 1980.

As of this date, the loss under the two highway bonds is in excess of $67,000. SBA's share is not yet finalized. The surety has been unable to make any recoveries on any of these bonds. This case was referred to the Department of Justice in July 1981, and is now under investigation by the New Orleans Division of the FBI.

The **Chairman**. And, last, please discuss the *Builders United* case?

Mr. **Boucher**. Yes, sir, in August and October 1976, SBA guaranteed two bonds, again executed by AFF, for Builders United Construction Co. The contracts were for the construction of law offices and a church. The contracts totaled $248,000.

Defaults on both contracts resulted in SBA's payment of claims totaling $95,000.

The findings are that UIB moved to recover a portion of the surety's loss under the general indemnity agreement executed by the principals of Builders. A suit was filed against AFF, however, and it resulted in the Arkansas Supreme Court deciding that the general indemnity agreement was unenforceable against Builders, because the bonds had been written by an agent of AFF, who was not licensed to do business in the State of Arkansas.

In this case, the failure of AFF to insure that its agent was properly licensed, at a minimum, to do business in that State denied SBA of any loss recoveries on the contract and cost the taxpayers $95,000.

The CHAIRMAN. The last four cases you outlined involved the American Fidelity Fire Insurance Co. The managing agent for the surety in these four cases was Market Insurance, and UIB adjusted these claims. What is the relationship between these two companies?

Mr. BOUCHER. As I understand, Mr. Chairman, there is a familiar relationship, that the same family basically controls both companies through some form of a trust agreement.

The CHAIRMAN. Now, which two companies are we talking about?

Mr. BOUCHER. We're talking about Market and UIB.

The CHAIRMAN. The same family controls both Market and UIB?

Mr. BOUCHER. Yes, sir. Some people may argue with the controls portion because of the trust setup, but there is, I would suggest, something perhaps less than an arm's-length relationship.

The CHAIRMAN. You testified that AFF and Market blocked your efforts to conduct audits. Why do you think they stonewalled your auditors?

Mr. BOUCHER. My opinion is, Mr. Chairman, they probably found our audit findings rather embarrassing.

Second, I think that they were probably concerned about the fact that if we continued our efforts, they might have liability denied by SBA as a result of our findings of negligence in some of these things.

I think what is unfortunate is the attitude that is demonstrated. Here is a company that's been participating in our program for a number of years, writes the largest number of our bonds, and they're not willing to open up their books to inspection by the very people they're in partnership with. That, I think, is what was of concern to us. It was merely a technical amendment to the Small Business Act to overcome their objection.

The CHAIRMAN. What has been AFFs loss record as a participant in the surety bond guarantee program?

Mr. BOUCHER. I am told that, based upon available information, it's about a 62-percent loss default rate. That's according to insurance industry standards.

If we used SBA's estimate of number of bonds written over money paid out, it would be like a 6.7-percent loss rate. By industry standards, I think they're about 62 to 63 percent, Mr. Chairman.

The CHAIRMAN. And what would be the loss rate for a similar company that is considered to be well run?

Mr. BOUCHER. We have some companies here that have less than a 10-percent default rate. You might even hear from some of these people today. The average, I guess, or the good companies, is 40 percent or less. Very good companies are considerably less than 40 percent. If you keep the defaults down, you make more money.

The CHAIRMAN. Do you find any problem with the legal costs United Inspection Bureau charges to SBA?

Mr. BOUCHER. We found some problems, sir, and I believe that it stems from the fact there's really nothing in our regulations or the guarantee agreement regarding legal fees, per se, and you really have to relate legal fees to the definition of reimbursable losses. (See exhibit III beginning at p. 459.)

What we found when we went out to UIB in California and discussed with their chief claims attorney out there how they accounted for legal fees, we found there was some double billing going on. We also found that they had hired attorneys and paid them salaries amounting to perhaps $120,000 a year to work on SBA-related claims. Through an hourly billing system, we paid those same attorneys $628,000.

So I'm a little bit concerned that our rules and regulations and our guarantee agreements——

The CHAIRMAN. Let me track that again. I don't quite follow. They were paid what?

Mr. BOUCHER. They were paid, shall we say, $30,000 to $40,000 per year per attorney, or roughly $120,000. That's what UIB paid their attorneys to work on our claims. UIB turned around and sent an hourly rate and billed us by the hour for their work, and the billings would amount to about $635,000, or more than five times what it's costing UIB for that attorney talent.

The CHAIRMAN. Do you have any idea of how much the Government is losing unnecessarily through the surety bond guarantee program?

Mr. BOUCHER. Mr. Chairman, I think what I can say is that I've outlined what we've experienced in terms of the horrendous state of the records of SBA. I don't think anybody can say with any certainty what we are losing. That's the difficult part, the unfortunate part, and rather a frightening part, also.

I would suggest, however, that with the procedures we have seen, and if we only look at contracts written by AFF and IFI, it is quite possible—quite likely—that we are talking about several millions of dollars in further losses just with these two companies alone.

So we are talking, I think, potential losses. I think these cases demonstrate up to $1 million, just the ones we've discussed today, where mismanagement, fraud, abuse, and waste has resulted in some very big dollar items being paid for by the Government.

So I would have to say I wouldn't take issue with any statement that the potential loss is in the millions of dollars.

The CHAIRMAN. Do you have any suggestion as to how we come at this problem? The difficulty is, I suppose the temptation is just to call a moratorium on the whole operation. The difficulty with that is that in these very difficult economic times, small businesses are having a tough enough time getting there hands on capital, or getting work and staying in business, if you will, that any such moratorium is going to bang the hell out of the small business people.

But what do we do? It's only been a year or so since we sat across from each other, and there were a different set of examples but the conclusion was very much the same. Now, here we are again. Millions of dollars are being lost. What do we do to stop this tomorrow?

Mr. BOUCHER. Mr. Chairman, I'd first of all like to suggest that the program officials be given an opportunity to testify before you. I have my ideas. I've made some recommendations in here.

Let me just suggest, up front——

The CHAIRMAN. What do you think the key is? I know there have been extensive proposals, and I intend to look at them, but what's the key to stopping this?

Mr. BOUCHER. Let me go back to a question a couple of people asked me: How do you keep organized crime out of our program? How do you keep anybody who is bent on defrauding us or taking advantage of a system which is very loosely structured?

I think when you have poor management, poor internal controls, it's an open invitation to what we've seen. In terms of organized crime, if you don't control what you're doing, if you don't run some kind of checks on what the people are doing to remove the incentive for illicit profit, you're going to continue to have these program problems.

You've got to tell the sureties what's expected of them, you've got to have a vigorous oversight, you've got to put resources in the program. SBA has to decide that they're going to take some people out of here and put them in the surety bond guarantee program. It's an important program. In terms of its dollars and its dollar impact on small business, it's second only to our loan programs.

There's no one thing, Mr. Chairman.

The CHAIRMAN. Well, what bothers me is the organized crime connection, which was well established at the last hearings, and yet SBA and the Treasury Department are still permitting people, from the very same companies that have that stigma attached, to carry on the same as before. I mean, what is necessary to have somebody say, "No, we're not going to license you"?

As I understand it—I don't want to get ahead of myself and the testimony that's going to come to pass—but as I understand it, in many States, my own State of Connecticut included, some of these companies have been delicensed, and are not permitted to do business. Now, I know we don't have any sort of a Federal insurance commission, and I'm not advocating that, but it seems to me neither Treasury nor SBA is willing de facto to say, "We're not going to deal with these people."

Mr. BOUCHER. Mr. Chairman, there are some hard decisions that are going to be made here. If you delicense some of the big bonding companies, you are going to in fact, I think, hurt some of the small businesses, because the large standard sureties, for the most part have been reluctant to get involved in this program.

The CHAIRMAN. But I'm not talking about them. I'm talking about IFI and AFF.

Mr. BOUCHER. If you delicense them, what I'm suggesting, Mr. Chairman, is that the only alternative is to try to get the larger underwriting companies into the program. They have been reluctant to get in because it's nickels and dimes to them.

I'm thinking what you have to do with AFF and IFI is hold them strictly accountable. Give them some incentive to reduce the losses that they pass on to us.

The **Chairman**. Even though you know organized crime is a part of their operation—as long as you hold them strictly accountable, you're going to allow them to operate?

Mr. **Boucher**. No, I think what we have to say here is, I can't say that organized crime is a part of IFI's operation. IFI has allowed certain of its agents to participate who have organized crime associations. That's their responsibility. Now, they've got to do something about that.

I don't know what IFI or AFF's position is on that, but I think you've raised a good issue: What do we do about these kinds of people when there is an agent relationship? I don't have one clear answer. I think the answer is that SBA has opened itself up to a lot of the problems we see today, because, I don't know of one case where we've ever denied liability on a bond.

The **Chairman**. You don't know of one case?

Mr. **Boucher**. No, sir, in spite of what we see here, and the reason for that, let me suggest, is because nobody has been out there checking and finding out that Spight Landscaping, Western Environmental, and Jace Industries have been potentially defrauding us. There's no checking. We rely totally on the underwriters and on the surety companies.

In fact, Mr. Chairman, the way we pay our claims is as follows: We pay our claims in Washington, D.C. We get a computer printout from a company on a claim. It lists all the dollars. No backup verification, no invoices, the college students add up the numbers, they jive, they send a check out. That's how we pay claims.

The **Chairman**. That's the process by which a claim is paid?

Mr. **Boucher**. That's how claims are paid. With AFF, that's the way claims are paid. Other companies do much better. We have canceled checks from one company, Morrison, we have financial statements and sheets from other companies, but with respect to some of the underwriters, the people who do the volume, they send a computer printout to us with such enlightening things as "Miscellaneous expenses, $1,979." We pay it.

The **Chairman**. Let's make the document you have there part of the record, if we could.

[Material follows:]

48

CO: 200 UNITED INSPECTION BUREAU, INC. SURETY BONDS BORDEREAU PROCESSING DATE 12/08/81 PAGE: 1
IC: 49 AMERICAN FIDELITY FIRE INS. INCEPTION TO 12/08/81 REPORT # BC 525

PRINCIPALS NAME:FARRITRON CORPORATION SBG NUMBER:8470-00010-075-34
PRINCIPALS TRADE NAME:N/A CLAIM NUMBER:00941249

BOND NUMBER: 746 - 2719795

PD. $677.09
12/22/81
Action No. 57

| AMOUNT DISBURSED BY SURETY | PAYEE | DRAFT NUMBER | DATE OF DRAFT | TYPE OF DISBURSEMENT | 90 PERCENT OF DRAFT ISSUED | AMOUNT OF SBA REIMBURSEMENT REQUESTED |
|---|---|---|---|---|---|---|
| 120.00 | UNITED INSPECTION BUREAU | 296227 | 7/27/79 | UIB MSC EXP | 108.00 | |
| 140.58 | GERALD, BRAND, WATTERS, COX & | 296445 | 7/31/79 | ATT PER EXP | 126.52 | |
| 30.00 | UNITED INSPECTION BUREAU | 296633 | 8/03/79 | UIB MSC EXP | 27.00 | |
| 15.00 | UNITED INSPECTION BUREAU | 296905 | 8/10/79 | UIB MSC EXP | 13.50 | |
| 60.00 | GERALD, BRAND, WATTERS, COX & | 293132 | 8/13/79 | ATT PER EXP | 54.00 | |
| 193.98 | GERALD BRAND (ERROR RE-IMPUT) | 300126 | 9/20/79 | ATT PER EXP | 174.58 | |
| 15.00 | UNITED INSPECTION BUREAU | 300681 | 10/23/79 | UIB MSC EXP | 13.50 | |
| 45.00 | GERALD, BRAND, WATTERS, COX & | 301408 | 10/29/79 | ATT PER EXP | 40.50 | |
| 15.00 | UNITED INSPECTION BUREAU | 301717 | 11/12/79 | UIB MSC EXP | 13.50 | |
| 15.00 | UNITED INSPECTION BUREAU/8071 | 304923 | 1/23/80 | UIB MSC EXP | 13.50 | |
| 2,199.71 | GERALD BRAND WATTERS COX/8024 | 305063 | 1/24/80 | ATT PER EXP | 1,979.74 | |
| 663.69 | GERALD BRAND WATTERS | 306425 | 2/27/80 | ATT PER EXP | 597.32 | |
| 492.05 | GERALD BRAND WATTERS COX & HEM | 307132 | 3/14/80 | ATT PER EXP | 442.85 | |
| 266.29 | GERALD BRAND WATTERS COX & HEM | 308113 | 4/10/80 | ATT PER EXP | 239.66 | |
| 16,477.20 | SHORE-COLEMAN WATER ASSOCIATIO | 307758 | 4/10/80 | COMPL PER | 14,829.48 | |
| 122.50 | UNITED INSPECTION BUREAU/8071 | 308318 | 4/14/80 | UIB MSC EXP | 110.25 | |
| 52.50 | UNITED INSPECTION BUREAU/8071 | 308552 | 4/18/80 | UIB MSC EXP | 47.25 | |
| 1,534.00 | HEALY-RUFF COMPANY | 308214 | 4/29/80 | COMPL PER | 1,380.60 | |
| 2,015.26 | OTT & PURDY | 308213 | 4/29/80 | ATT PER EXP | 1,813.73 | |
| 70.00 | UNITED INSPECTION BUREAU/8071 | 309006 | 4/30/80 | UIB MSC EXP | 63.00 | |
| 35.00 | UNITED INSPECTION BUREAU/8071 | 309540 | 5/13/80 | UIB MSC EXP | 31.50 | |
| 2,499.02 | EDGCOMB METALS COMPANY | 309620 | 5/15/80 | CLM PER LAB | 2,249.12 | |
| 1,004.06 | GERALD BRAND WATTERS COX & HEM | 309621 | 5/15/80 | ATT PER EXP | 903.65 | |
| 35.00 | UNITED INSPECTION BUREAU/8071 | 321279 | 5/26/80 | UIB MSC EXP | 31.50 | |
| 263.00 | BILLY AKERS | 321426 | 5/28/80 | CLM PER LAB | 236.70 | |
| 434.41 | GERALD BRAND WATTERS COX & HEM | 321427 | 5/28/80 | ATT PER EXP | 390.97 | |
| 1,170.00 | BRADFORD W. GARVIN | 321428 | 5/28/80 | CLM PER LAB | 1,053.00 | |
| 185.05 | OTT & PURDY, ATTORNEYS AT LAW | 321799 | 6/11/80 | ATT PER EXP | 166.55 | |
| 17.50 | UNITED INSPECTION BUREAU/8071 | 322160 | 6/20/80 | UIB MSC EXP | 15.75 | |
| 1,731.93 | FOUR STAR BUILDING SUPPLY COMP | 322240 | 6/25/80 | CLM PER LAB | 1,558.74 | |
| 105.00 | UNITED INSPECTION BUREAU/8071 | 324237 | 8/11/80 | UIB MSC EXP | 94.50 | |
| 173.75 | OTT & PURDY, ATTORNEYS AT LAW | 324431 | 8/19/80 | ATT PER EXP | 156.38 | |
| 463.01 | DIXIE WHOLESALE WATERWORKS, IN | 324432 | 8/19/80 | CLM PER LAB | 416.71 | |
| 719.21 | OTT & PURDY | 324527 | 8/28/80 | CSLT PER EXP | 647.29 | |
| 35.00 | UNITED INSPECTION BUREAU/8071 | 325122 | 9/04/80 | UIB MSC EXP | 31.50 | |
| 117.80 | OTT & PURDY, ATTORNEYS AT LAW | 325704 | 9/23/80 | ATT PER EXP | 106.02 | |
| 70.00 | UNITED INSPECTION BUREAU/8071 | 327294 | 10/27/80 | UIB MSC EXP | 63.00 | |
| 105.00 | UNITED INSPECTION BUREAU/8071 | 328576 | 11/21/80 | UIB MSC EXP | 94.50 | |
| 182.59 | OTT & PURDY, ATTORNEYS AT LAW | 328912 | 12/11/80 | ATT PER EXP | 164.33 | |
| 1,920.00 | CAWTHON STEEL COMPANY, INC. | 329477 | 12/19/80 | CLM PER LAB | 1,728.00 | |
| 164.60 | OTT & PURDY, ATTORNEYS AT LAW | 329646 | 12/31/80 | ATT PER EXP | 148.14 | |
| 35.00 | UNITED INSPECTION BUREAU/8071 | 330422 | 1/15/81 | UIB MSC EXP | 31.50 | |
| 70.00 | UNITED INSPECTION BUREAU/8071 | 333594 | 4/17/81 | UIB MSC EXP | 63.00 | |
| 3,678.84 | WORSHAM BROTHERS | 508151 | 5/05/81 | CLM PER LAB | 3,310.96 | |
| 37.50 | UNITED INSPECTION BUREAU/8071 | 510428 | 5/15/81 | UIB MSC EXP | 33.76 | |
| 1,050.00 | ALLIED EQUIPMENT, INC. | 510761 | 5/27/81 | CLM PER LAB | 945.00 | |

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CO:   200  UNITED INSPECTION BUREAU, INC.              SURETY BONDS BORDEREAU                      PROCESSING DATE 12/08/81 PAGE:    2
IC:    49  AMERICAN FIDELITY FI*E INS.                 INCEPTION TO  12/08/81                      REPORT # BC 525

        PRINCIPALS NAME:FARRIIRON CORPORATION                                    SBG NUMBER:0470-00010-075-34
   PRINCIPALS TRADE NAME:N/A                                                  CLAIM NUMBER:00941349

   BOND NUMBER: 746 - 2719795

       AMOUNT                                                                                                        AMOUNT OF SBA
     DISBURSED    PAYEE                                     DRAFT    DATE OF     TYPE OF            90  PERCENT      REIMBURSEMENT
     BY SURETY                                              NUMBER    DRAFT    DISBURSEMENT       OF DRAFT ISSUED      REQUESTED
   -------------  ------------------------------------      ------   -------   ------------      ---------------     -------------
           75.00  UNITED INSPECTION BUREAU/8071             S00807   6/08/81   UIB MSC EXP                 67.51
          434.18  OTT & PURDY, LTD. ATTYS AT LAW            S01153   6/16/81   ATT PER EXP                390.74
          168.20  OTT & PURDY, LTD. ATTYS AT LAW            S02465   7/21/81   ATT PER EXP                151.38
          150.00  UNITED INSPECTION BUREAU/8071             S04491   9/08/81   UIB MSC EXP                135.00
          187.50  UNITED INSPECTION BUREAU/8071             S05295  10/01/81   UIB MSC EXP                  0.00
                  -> Non-Reimbursable item
       41,859.88    TOTAL PAYOUT                                                                                    37,505.18

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        2,114.34  P 1                                       S0090    4/17/80   SBA REIMBRSE             2,114.34
       26,161.62  P.1                                       S0090   12/05/80   SBA REIMBRSE            26,161.62
        3,475.79                                            S0090    3/05/81   SBA REIMBRSE             3,475.79
        4,626.31  P.1                                       S0090    7/17/81   SBA REIMBRSE             4,626.31

       36,378.06    TOTAL RECOVERY

=======================================================================================================================================
 I.  SURETY REIMBURSEMENT REQUEST                          II. CLAIM RESERVE STATUS                   III. RECOVERY STATUS
     A. ACTUAL SURETY PAY-OUT             41,859.88            A. INCURRED LOSS           41,859.88       A. CONTRACT / INDEMNITY
     B. DEDUCTIBLE AMOUNT                    500.00            B. SURETY PAY-OUT          41,859.88                  RECOVERY         0.00
     C. SURETY PAY-OUT NONREIMB.             187.50            C. RESERVE                      0.00
     D. SBA SHARE AT  90 PER CENT         37,055.18            D. CHANGE IN RESERVE        2,009.09-      B. SBA REFUND               0.00
        1. NET CONT./INDMNTY.REC.              0.00
        2. SBA PAID                       36,378.06
        3. SBA BILLED NOT RECEIVED              N/A
        4. SBA BILLED TO DATE             37,055.18
        5. SBA PAID TO DATE               36,378.06
        6. SBA BILLED OUTSTANDING            677.12
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CENTRAL OFFICE

The **Chairman**. Senator Rudman.

Senator **Rudman**. It certainly would appear from your testimony that the central problem is not that we're dealing with a sophisticated scheme. This is not very sophisticated fraud. This is very simple, straightforward, almost bordering on embezzlement.

To follow up on the chairman's question, I understand the reluctance of some of the major surety companies to engage in this program, but what single thing could you do that would start to improve the loss ratios? Would not that single thing be evolving a prequalification standard, if you will, for those who engage in this program? Certainly, under a prequalification standard system, such as many agencies use, a lot of these people would be eliminated.

Mr. **Boucher**. We could do that. We could screen them very carefully at the front end in order to get the better companies, to have them demonstrate that they have underwriting standards that meet our qualifications, that they have a claims processing system that meets our qualifications, and by the same token, I would add, Senator Rudman, that if we did some of these things to show that we've got our own act together, we might be able to get some of the bigger companies in the program.

Senator **Rudman**. Certainly, you know, this does not take three committees within the SBA, it would seem, to study. I don't think that anybody would have to hire consultants to decide how to do that. It would seem that that's something that could be done relatively quickly, that it could be done tomorrow, that the top management of SBA could decide, "We are going to stop this program dead in its tracks, and we're going to spend the next 4 weeks prequalifying, and part of that prequalification process is going to evolve from past history," because there isn't a much better way to evaluate who you qualify than looking at history, and that's not just true in the SBA, that's true in any State agency that does any great amount of purchasing.

So to your knowledge—you're maybe not the right witness; I'll ask this to someone else—but to your knowledge has anyone got involved with deciding that they're going to start prequalification over there?

Mr. **Boucher**. To my knowledge, that's not one of the initiatives that's been undertaken, Senator Rudman.

Senator **Rudman**. Can you think of a better one?

Mr. **Boucher**. Not offhand, I can't.

Senator **Rudman**. Neither can I.

Thank you, Mr. Chairman.

The **Chairman**. Thank you, Senator Rudman.

I'll tell you one step that I think can be accomplished almost immediately—when we have Mr. Templeman before us, I intend to raise the issue—it seems to me there have got to be some consulting funds available in the administration's budget. If they aren't, I'll see that they get them and that we get somebody aboard over at SBA on a consultant basis who understands the insurance business and is capable of setting up that department the way it ought to be set up.

Now, I think that can be done right away. Clearly, from what you say, with college students and only one person who has any expertise at all running around this department, you're not going to be able to do much in terms of checking the abuses. On the other hand, it seems to me that with some expert outside advice, the program could be structured so as to at least begin to prevent these types of abuses from occurring.

Mr. BOUCHER. Mr. Chairman, I think there are a number of initiatives that can be undertaken to bring the program under control.

The CHAIRMAN. All right, fine. Thank you very much, Mr. Boucher.

Senator RUDMAN. Mr. Chairman, I just might add——

The CHAIRMAN. Yes, go ahead.

Senator RUDMAN [continuing]. Before this witness leaves, that the staff just handed to me their usual excellent research. The little State of New Hampshire, with an insurance department that would fit into one corner of the Custodial Department of the SBA, has by letter of February 12 advised you, Mr. Chairman, that AFF is not licensed in New Hampshire, and the reason they're not licensed in New Hampshire is because of their financial situation and poor record in handling claims. (See exhibit IVa beginning at p. 461.)

The State of New Hampshire, with a small insurance department is, trying to protect its citizens, because if it didn't, in a small state like New Hampshire, somebody's head would be lopped off, probably the insurance commissioner's, and he has found that this is a company that he doesn't want to do business in our State.

It would seem to me that the Federal Government has the facilities and the resources, if they're properly applied, to do the same thing.

I would expect the State of Connecticut probably took the same position. (See exhibit IVb beginning at p. 462.)

The CHAIRMAN. It did.

Thank you very much, Mr. Boucher.

[The prepared statement of Mr. Boucher follows:]

# STATEMENT OF
# PAUL R. BOUCHER, INSPECTOR GENERAL
# UNITED STATES SMALL BUSINESS ADMINISTRATION
# BEFORE THE
# COMMITTEE ON SMALL BUSINESS
# UNITED STATES SENATE

MARCH 11, 1982

MR. CHAIRMAN AND MEMBERS OF THE COMMITTEE, THIS IS THE SECOND TIME IN LESS THAN TWO YEARS I HAVE APPEARED BEFORE THIS COMMITTEE TO TESTIFY ON THE STATE OF THE SMALL BUSINESS ADMINISTRATION'S (SBA) SURETY BOND GUARANTEE (SBG) PROGRAM. AS YOU WILL RECALL, YOUR COMMITTEE STAFF AND THE OFFICE OF INSPECTOR GENERAL (OIG) OF SBA WORKED CLOSELY TO DEVELOP INFORMATION WHICH WAS BROUGHT OUT IN THE FIRST HEARINGS HELD IN SEPTEMBER 1980. THAT EFFORT RESULTED IN THE DISCLOSURE THAT CERTAIN INDIVIDUALS KNOWN TO BE INVOLVED IN OR ASSOCIATED WITH ORGANIZED CRIME IN CHICAGO, ILLINOIS, HAD PARTICIPATED IN THE SBG PROGRAM. UNFORTUNATELY, TODAY I WILL AGAIN HAVE TO INFORM THE COMMITTEE THAT OUR AUDIT EFFORTS HAVE DISCLOSED THE INVOLVEMENT OF YET ANOTHER ORGANIZED CRIME ASSOCIATE IN THE SBG PROGRAM.

AT YOUR LAST HEARING, WE ALSO REPORTED THAT THE OIG HAD ONGOING A NUMBER OF ACTIVITIES COVERING THE SBG PROGRAM. AT YOUR REQUEST, I AM PREPARED TO PROVIDE YOU WITH A MORE IN-DEPTH ASSESSMENT OF THE PROGRAM BASED ON THE RESULTS OF THIS EFFORT.

INITIALLY, LET ME STATE THAT THE CONCERN DEMONSTRATED BY THIS COMMITTEE AS EXEMPLIFIED BY ITS VIGOROUS OVERSIGHT OF THE SBG PROGRAM OPERATIONS, IS FULLY WARRANTED. THE SBG PROGRAM IS AN IMPORTANT ONE. IT IS A PROGRAM WHICH HAS PERFORMED AND CAN CONTINUE TO PROVIDE A VALUABLE SERVICE TO SMALL BUSINESS BY MAKING AVAILABLE TO IT OPPORTUNITIES WHICH COULD NOT OTHERWISE EXIST WITHOUT THE BACKING OF THE FEDERAL GOVERNMENT. IT IS NOTEWORTHY THAT SINCE ITS IMPLEMENTATION IN SEPTEMBER 1971, THIS PROGRAM HAS PROVIDED BOND GUARANTEES ON MORE THAN 142,000 CONTRACTS IN BOND AMOUNTS APPROXIMATING $10.7 BILLION. ON THE OTHER SIDE OF THE LEDGER, DURING THIS SAME TIME MORE THAN 8,000 CONTRACTS HAVE GONE INTO DEFAULT WHICH HAVE RESULTED IN NET CLAIMS PAYMENTS BY SBA TO PARTICIPATING SURETIES OF ABOUT $178 MILLION.

IN TERMS OF ITS DAY-TO-DAY DIRECTION AND CONTROL, THE PROGRAM CAN BE DESCRIBED AS ONE IN WHICH SBA HISTORICALLY HAS DELEGATED VIRTUALLY ALL DISCRETION TO SURETY COMPANIES AND THEIR AGENTS. IN MANY RESPECTS, OUR PARTICIPATING SURETIES HAVE CONDUCTED THEMSELVES IN A RESPONSIBLE AND PROFESSIONAL MANNER AND APPEAR TO HAVE SERVED WELL THE INTERESTS OF SMALL BUSINESS AND THE TAXPAYER. IT IS MY UNDERSTANDING THAT YOU WILL HEAR FROM REPRESENTATIVES FROM SOME OF THESE COMPANIES TODAY. UNFORTUNATELY, AND FOR REASONS WITH WHICH THE COMMITTEE IS FAMILIAR, SBA'S OWN MANAGEMENT SHORTCOMINGS AS WELL AS THE ACTIONS OF SOME OF OUR PARTICIPATING SURETIES AND THEIR AGENTS GIVE CAUSE FOR CONSIDERABLE CONCERN ABOUT THE STATE OF THE PROGRAM.

WITH RESPECT TO OUR PARTICIPATING SURETIES, I MUST EMPHASIZE THAT OUR PRIMARY CONCERN RELATES ONLY TO A RELATIVELY FEW SURETY COMPANIES WHICH ARE CALLED "SPECIALTY COMPANIES", APPARENTLY BECAUSE THEY SPECIALIZE IN AND TO A SIGNIFICANT EXTENT SUBSIST ON THE BUSINESS THEY WRITE IN THE SBG PROGRAM. UNFORTUNATELY, HOWEVER, IT IS THOSE FEW SPECIALTY COMPANIES WHICH HAVE WRITTEN THE LION'S SHARE OF THE BONDS WITH WHICH THIS COMMITTEE AND THE OIG HAVE THE GREATEST CONCERN.

FIRST OF ALL, AND BY WAY OF EXPLANATION, LET ME DISCUSS GENERALLY HOW A SURETY BOND TRANSACTION MIGHT OCCUR. A SMALL BUSINESS PERSON IS PRESENTED WITH AN OPPORTUNITY TO PERFORM ON A CONTRACT. ONE ELEMENT OF THE PROCESS REQUIRES THAT THE CONTRACTOR BE BONDED. AN APPROACH BY THE SMALL BUSINESS PERSON TO AN UNDERWRITER DISCLOSES THE UNDERWRITER'S RELUCTANCE TO PROVIDE A BOND IN THE ABSENCE OF AN SBA GUARANTEE. SBA IS APPROACHED BY THE PARTIES AND AGREES TO GUARANTEE THE BOND. IN MOST CASES, THE SBA AGREES TO GUARANTEE 90 PERCENT OF ANY LOSSES INCURRED BY THE SURETY COMPANY REPRESENTED BY THE UNDERWRITER IN RETURN FOR 20 PERCENT OF THE BOND PREMIUM. UPON DEFAULT, CLAIMS ATTORNEYS OR CLAIMS ADJUSTERS FOR THE SURETY COMPANY SELECT A CONTRACTOR TO COMPLETE THE UNFINISHED PROJECT AND BILL THE SBA, THROUGH THE PARTICIPATING SURETY, FOR COSTS INCURRED AS A RESULT OF THE DEFAULT.

WHILE THE ENTIRE PROCESS MAY APPEAR TO BE STRAIGHTFORWARD IN THE RATHER BASIC MANNER OUTLINED, I THINK THE RESULTS OF THE AUDIT AND INVESTIGATIVE WORK OF THE OIG AND OTHER ORGANIZATIONS SINCE THE PROGRAMS' INCEPTION IN SEPTEMBER 1971 WILL SERVE TO ILLUSTRATE THE PROBLEMS STILL FACING THE PROGRAM AFTER MORE THAN 10 YEARS OF OPERATION.

IN FEBRUARY 1973 AND AUGUST 1974, SBA AUDITORS CONDUCTED A PRELIMINARY REVIEW OF THE SBG PROGRAM. THEIR REPORTS NOTED THE ABSENCE OF REVIEW AND OVERSIGHT OF UNDERWRITING ACTIVITIES ON THE PART OF SURETY COMPANY AGENTS AND THE LACK OF POLICIES AND PROCEDURES REQUIRED OF UNDERWRITERS IN PROCESSING CLAIMS ON DEFAULTED CONTRACTS. PROGRAM OFFICIALS AGREED ON THE NEED FOR POLICY GUIDANCE IN BOTH AREAS TO ENSURE THE PROGRAM WAS BEING OPERATED EFFICIENTLY AND EFFECTIVELY.

IN JUNE 1975, A SECOND REVIEW OF THE SBG PROGRAM DISCLOSED THE CONTINUING ABSENCE OF ANY UNDERWRITING GUIDELINES FOR PARTICIPATING SURETIES AGAINST WHICH UNDERWRITING ACTIVITIES COULD BE EVALUATED AND MONITORED BY SBA PROGRAM PERSONNEL.

PROGRAM OFFICIALS AGREED WITH THE AUDITORS ONCE AGAIN THAT THESE GUIDELINES WERE NEEDED. IN EFFECT, AFTER 4 YEARS OF OPERATION, SBA STILL HAD ISSUED NO UNDERWRITING GUIDELINES FOR USE BY PROGRAM PARTICIPANTS, KNEW LITTLE--IF ANYTHING--ABOUT THE CLAIMS PROCESSING FUNCTIONS OF THE PARTICIPANTS, AND HAD TAKEN VIRTUALLY NO STEPS TO BRING ABOUT UNIFORMITY AND CONTROL. THE RESULTS OF THESE SHORTCOMINGS WERE PREDICTABLE.

In 1977, the OIG undertook a limited review of claims filed with SBA to uncover evidence of fraud, mismanagement or other indications of program weaknesses. The review covered claims filed by the American Fidelity Fire Insurance Company (AFF) of New York and the International Fidelity Insurance Company (IFI) of Newark, New Jersey. At that time, AFF was the single largest participant in the SBG program with approximately 45 percent of surety bond volume.

Based on available data, these two sureties alone have accounted for nearly 44 percent of all claims filed to date on bonds written prior to January 1, 1979. Translated into dollars, of the $129 million thus far paid by SBA on bonds written up to that date, these two sureties have received $56 million, or 43 percent of the dollars paid on these claims.

Following the review of 31 claims, auditors cited the following exceptions:

- Inadequate underwriting procedures in 29 claims.
- Eligibility or justification for SBA guarantees was questioned in 21 claims.
- Failure to provide timely notice of default in 11 claims.

- REIMBURSEMENT OF QUESTIONABLE ADMINISTRATIVE COSTS IN 11 CLAIMS.

- INCOMPLETE OR INADEQUATE ACCOUNTING FOR CONTRACT RECOVERIES IN 13 CLAIMS.

- VIOLATIONS OF U.S. TREASURY UNDERWRITING LIMITATIONS IN 11 CLAIMS.

- FRAUD OR MATERIAL ALTERATIONS OF UNDERWRITING CONDITIONS IN 6 CLAIMS.

THESE FINDINGS WERE PRESENTED TO THE PROGRAM OFFICIALS, CAUSING SOME DISMAY. OUR ACTIVITIES APPARENTLY CAUSED SOME CONCERN WITHIN AFF AS WELL, A CONCERN WHICH MANIFESTED ITSELF IN A LEGAL CHALLENGE BY AFF TO OUR VERY AUTHORITY TO CONDUCT ROUTINE EXAMINATIONS OF ITS RECORDS AND THOSE OF ITS AGENT. AS A RESULT OF AN OPINION FROM THE SBA OFFICE OF GENERAL COUNSEL THAT THE AFF CHALLENGE DID HAVE A VALID BASIS IN LAW, THE OIG WAS FORCED TO CURTAIL ITS AUDIT ACTIVITY ON JANUARY 26, 1978. IN OCTOBER 1978, THE SMALL BUSINESS ACT WAS AMENDED TO CLARIFY THE AUTHORITY OF SBA TO CONDUCT ROUTINE EXAMINATIONS.

I WOULD NOTE THAT WHILE AFF'S CHALLENGE TO OUR AUTHORITY DID HAVE A BASIS IN LAW, IT WOULD NOW APPEAR THAT THEIR REFUSAL MIGHT WELL HAVE BEEN MOTIVATED MORE BY OUR AUDIT FINDINGS, AND THE POSSIBILITY THAT THEY MIGHT BE USED AS A BASIS FOR SBA'S DENIAL OF LIABILITY ON SOME OF AFF'S CLAIMS, THAN THEIR DESIRE TO VINDICATE A TECHNICAL LEGAL PRINCIPLE.

IN DECEMBER 1979, THE GENERAL ACCOUNTING OFFICE (GAO) CONDUCTED A REVIEW OF THE SBG PROGRAM NOTING THE LACK OF UNDERWRITING GUIDELINES, THE ABSENCE OF SYSTEMS OR PROCEDURES FOR CLAIMS PROCESSING, AND THE LACK OF INCENTIVES ON THE PART OF SURETIES TO MITIGATE LOSSES.

DURING THE SPRING OF 1980, THE OIG AGAIN FOCUSED ITS ATTENTION ON THE SBG PROGRAM. AS I NOTED AT THE OUTSET, A JOINT EFFORT BY THE OIG AND COMMITTEE STAFF YIELDED EVIDENCE OF INVOLVEMENT BY ORGANIZED CRIME FIGURES IN CHICAGO, ILLINOIS.

AT A HEARING IN SEPTEMBER 1980, THE COMMITTEE HEARD EVIDENCE THAT IRWIN WEINER, AN ORGANIZED CRIME ASSOCIATE WHO WAS UNPRODUCTIVELY SUBPOENAED BEFORE THE COMMITTEE, WAS AN AGENT FOR IFI AND HAD UNDERWRITTEN A NUMBER OF BONDS GUARANTEED BY SBA. OTHER PERSONS INVOLVED WITH WEINER KNOWN TO HAVE ORGANIZED CRIME CONNECTIONS WERE JOSEPH COSENTINO, WILLIAM BALLY, MITCHELL CAPLAN, AND MITCHELL AND MARSHALL CAIFANO. I WOULD NOTE THAT IN 1981, BOTH MR. COSENTINO AND MR. BALLY APPLIED FOR AUTHORITY TO PARTICIPATE IN THE SBG PROGRAM.

Mr. Cosentino's request was denied, Mr. Bally's is still pending a decision from SBA. Our investigations of the activities of Weiner and his associates were referred to the Department of Justice (DOJ) due to the existence of possible fraud in a number of transactions involving these individuals and their companies.

At about the same time these hearings took place, the OIG had undertaken or was in the process of initiating a three part effort related to various aspects of the SBG program.

One phase of this effort involved the further review of a number of large claims which had been paid by SBA for the purpose of determining the existence of fraud or other improprieties connected with these transactions. To this end, we conducted audits of 14 claims submitted to SBA by 4 different sureties: the Balboa, IFI, Heritage, and Dependable Insurance Companies. Payments made by SBA on these 14 contract claims totalled just under $3 million.

Evidence of possible fraud sufficient to warrant referral to the DOJ was discovered in three of the 14 claims audited. SBA payments made in these three cases totalled about $650,000. As a result of evidence developed by one of these audits, a Federal Grand Jury in Chicago, Illinois, recently returned a 20-count indictment against Chicago attorney Melvin Dick and State Construction Company (State) President, Anthony Giacomino.

SINCE THIS MATTER IS NOW PENDING PROSECUTION WITH THE DOJ, I WILL LIMIT MY COMMENT ON THIS CASE. I CAN ADVISE THE COMMITTEE THAT THE FACTS UPON WHICH THE REFERRAL TO THE UNITED STATES ATTORNEY'S OFFICE WAS PREDICATED RELATED TO A $2.5 MILLION CONSTRUCTION CONTRACT AWARDED TO THE BERGEN CONSTRUCTION COMPANY (BERGEN) BY THE CITY OF CHICAGO.

IN OCTOBER 1976, BERGEN SUBCONTRACTED WITH MINORITY BUILDERS, INC., TO PERFORM CONCRETE WORK VALUED AT $213,500. MINORITY BUILDERS DEFAULTED ON ITS CONTRACT IN SEPTEMBER 1977 AND HERITAGE INSURANCE, A CO-INSURER WITH AFF ON THE CONCRETE SUBCONTRACT, REFERRED THE DEFAULT TO MELVIN DICK, A CLAIMS ATTORNEY. BASED ON DICK'S ESTIMATES OF THE COST OF COMPLETION, HERITAGE ISSUED A $196,000 CONTRACT TO THE STATE CONSTRUCTION COMPANY; WHOSE PRESIDENT WAS ANTHONY GIACOMINO. AT THE TIME OF THIS TRANSACTION, THE CITY OF CHICAGO HAD ESTIMATED THAT ONLY ABOUT $25,000 WOULD BE REQUIRED TO FULLY COMPLETE THE SUBCONTRACT.

RATHER THAN DO THE CONCRETE WORK ITSELF, STATE CONSTRUCTION SUBCONTRACTED THE ENTIRE CONCRETE COMPLETION PROJECT TO ANOTHER COMPANY FOR $88,650. THE PENDING FEDERAL INDICTMENT AGAINST DICK AND GIACOMINO ALLEGES VARIOUS COUNTS OF FRAUD AND MAIL FRAUD ASSOCIATED WITH THE MORE THAN $100,000 DIFFERENCE BETWEEN WHAT STATE RECEIVED AND WHAT IT PAID TO ITS SUBCONTRACTOR TO COMPLETE THE WORK.

With respect to the defendants in this case, the records of the Chicago Crime Commission reflect that Giacomino is regarded to be a known associate of organized crime figures in the Chicago area. He was indicted in January 1980 on Federal charges of receiving stolen property and conspiracy related to his involvement in snow removal contracts in the Chicago area. In connection with that case, he was served with a subpoena calling for the production of records located in a mobile home owned by him. Prior to the return date, the mobile home suffered an explosion which destroyed evidence of value to this case. That prosecution ended in a mistrial, his retrial is pending. With respect to the destruction of evidence, Giacomino was indicted on charges of mail fraud, obstruction, and destruction of property by explosives. He was recently convicted and sentenced to seven years in the custody of the Attorney General.

Given the background of Mr. Giacomino, it is ironic that the subcontract which formed the basis for his recent Federal indictment was for work he was to perform on a new Police Station for the City of Chicago.

MELVIN DICK HAS NO KNOWN PRIOR ASSOCIATION WITH GIACOMINO. HE FORMERLY SERVED AS A CLAIMS ATTORNEY FOR IFI IN THE CHICAGO AREA. HIS ONLY KNOWN CONNECTION WITH INDIVIDUALS OF INTEREST TO THIS COMMITTEE RELATES TO THE FACT THAT AS A PART OF HIS PROFESSIONAL RESPONSIBILITIES, HE HAD PROCESSED A NUMBER OF CONTRACT DEFAULT CLAIMS FOR THE BONDING AGENCY HEADED BY IRWIN WEINER.

A SECOND PHASE OF THIS PROJECT RESULTED IN AN INTERNAL AUDIT REPORT ISSUED BY THE OIG IN APRIL 1981, A COPY OF WHICH IS IN THE POSSESSION OF THIS COMMITTEE. SOME OF THE FINDINGS OF THIS AUDIT WERE NOT SURPRISING--NO UNDERWRITING STANDARDS HAD YET BEEN DEVELOPED, JUST AS REPORTED BY THE GAO NEARLY TWO YEARS EARLIER; NO CLAIMS PROCESSING PROCEDURES, NO DEFINITIONS OF REIMBURSABLE LOSSES, ETC., HAD BEEN DEVELOPED AND IMPLEMENTED, AS WAS REPORTED IN 1974; AND THERE EXISTED AN ABSENCE OF ANY INCENTIVES ON THE PART OF SURETIES TO MINIMIZE LOSSES. I WILL NOT GO INTO A DETAILED DISCUSSION OF THIS AUDIT REPORT SINCE THE FINDINGS THEREIN ARE THE BASIS FOR A NUMBER OF RECOMMENDATIONS I WILL MAKE AT A LATER POINT IN MY TESTIMONY.

OUR THIRD AND FINAL EFFORT IN THE SBG PROGRAM BRINGS US BACK TO AFF OF NEW YORK. YOU WILL RECALL THAT WE HAD TERMINATED OUR AUDIT WORK IN 1978 BECAUSE OF THEIR REFUSAL TO COOPERATE WITH SBA. AS A RESULT OF QUESTIONS LATER RAISED CONCERNING THE FINANCIAL VIABILITY OF AFF, THE OIG REQUESTED THE ASSISTANCE OF THE NEW YORK STATE INSURANCE COMMISSION (NYSIC) IN A MUTUAL EFFORT TO REVIEW AFF, THE MARKET INSURANCE COMPANY OF CALIFORNIA, ITS MANAGING AGENT; AND THE UNITED INSPECTIONS BUREAU (UIB) OF CALIFORNIA, ITS CLAIMS AGENT.

I WOULD LIKE TO TAKE THIS OPPORTUNITY TO PUBLICLY COMMEND THE NYSIC FOR ITS ASSISTANCE IN THIS MATTER; AN EXAMPLE OF EXCELLENT FEDERAL-STATE COOPERATION ON A MATTER OF MUTUAL CONCERN. AS A RESULT OF THIS ACTIVITY, THE FOLLOWING OBSERVATIONS WERE MADE BY THE NYSIC AND THE SBA-OIG:

- AS PART OF THE AUDIT, THE BOOK BALANCES OF AFF AND SBA ON 52 CLAIMS WERE SELECTED FOR CONFIRMATION BY THE NYSIC. DUE TO THE INADEQUACY OF BOTH UIB'S REPORTING OF CLAIMS INFORMATION AND SBA'S HANDLING OF INFORMATION RECEIVED, 42 OF THESE CLAIMS COULD NOT BE RECONCILED TO BALANCES ON AFF'S BOOKS.

- UIB DID NOT SUBMIT REQUIRED 6-MONTH STATUS REPORTS AND INVOICES IN A TIMELY MANNER. AS A RESULT, THE LACK OF MANAGERIAL CONTROL IN DEALING WITH THIS FUNCTION HAD SIGNIFICANTLY WEAKENED INTERNAL CONTROLS AND RESULTED IN AN INADEQUATE CLAIMS HANDLING SYSTEM.

- ATTEMPTS TO DEVELOP INFORMATION ON STATUS REPORTS AND OTHER CLAIMS DOCUMENTATION WERE DIFFICULT, IF NOT IMPOSSIBLE, IN SOME CASES DUE TO THE POOR STATE OF RECORDS WITHIN SBA. IN APPROXIMATELY 80 PERCENT OF THE CLAIMS REVIEWED, THE SBA COULD PROVIDE NO EVIDENCE OF HAVING RECEIVED A STATUS REPORT ON A DEFAULT WITHIN ONE YEAR OF ITS OCCURRENCE.

- BALANCES DUE AND OWING TO SBA WERE NOT BEING REMITTED ON A TIMELY BASIS. IN ONE 2-MONTH PERIOD IN 1980, AFF REMITTED $1 MILLION IN REFUNDS TO SBA AFTER THIS SITUATION WAS CALLED TO ITS ATTENTION.

- NYSIC CONSISTENTLY FOUND THAT THE REPORTING OF RESERVE REQUIREMENTS BY AFF WAS NOT DONE ON A TIMELY BASIS AND, WHEN REPORTED, WERE UNDERESTIMATED. AS A RESULT, SBA'S RESERVE LOSSES WERE ALSO BELIEVED TO BE UNDERESTIMATED.

- A REVIEW OF 200 CLAIMS FILES SUBSTANTIATED EARLIER GAO AND SBA FINDINGS THAT NECESSARY INFORMATION FOR THE ISSUANCE OF THESE BONDS BY THE UNDERWRITER, AND MEANINGFUL REVIEW BY SBA, WAS EITHER MISSING OR INCOMPLETE AND THAT NO UNDERWRITING STANDARDS WERE IN EFFECT.

THE RESULTS OF THIS JOINT UNDERTAKING ONLY SERVED TO FURTHER UNDERSCORE THE CHAOTIC STATE OF SBA'S SBG PROGRAM BOTH FROM THE STANDPOINT OF SBA'S CONTROL OF ITS ACTIVITIES AND THE ABSENCE OF MANAGEMENT AND CONTROL BY AFF AND ITS AFFILIATES.

HAVING DISCUSSED THE SIGNIFICANT PROBLEMS OF THE SBG PROGRAM, THE NEXT QUESTION WOULD SEEM TO BE: WHERE DO WE GO FROM HERE? BEFORE I ATTEMPT TO OFFER SOME SUGGESTIONS, HOWEVER, I THINK THAT SOMETHING MUST BE CONSIDERED AS PART OF ANY ATTEMPT TO ASSESS HOW WE GOT TO WHERE WE ARE TODAY. IN MY VIEW, AN ANALYSIS AS TO THE CAUSES OF THE PROBLEMS ASSOCIATED WITH THE SBG PROGRAM MUST BEGIN WITH A REVIEW OF THE OPERATIONS OF SBA, AS AN AGENCY, OVER THE YEARS.

THERE CAN BE NO DOUBT THAT IN THE LAST 10-15 YEARS, MAJOR CHANGES IN THE NATURE, SCOPE, AND BREADTH OF THE MISSION AND RESPONSIBILITIES OF THE SBA HAVE OCCURRED. NOT ONLY HAVE PROGRAM DELIVERY PROGRAMS EXPANDED CONSIDERABLY BUT, AT THE SAME TIME, SBA HAS BEEN REQUIRED TO TAKE ON A NUMBER OF NEW RESPONSIBILITIES.

BY WAY OF ILLUSTRATION, DURING THE 10-YEAR PERIOD BETWEEN 1970-1980, SBA'S LOAN PORTFOLIO HAS GROWN FROM $2 BILLION TO $17 BILLION, 8(A) CONTRACT AWARDS HAVE GONE FROM 400 IN 1970 TO NEARLY 5,000 IN 1980, THERE HAS BEEN THE DEVELOPMENT OF THE SMALL BUSINESS INSTITUTE AND SMALL BUSINESS DEVELOPMENT CENTER PROGRAMS: THE NON-BANK LENDER, CERTIFIED LENDER AND 503 LOCAL DEVELOPMENT COMPANY PROGRAMS HAVE BEEN INSITUTED; A SIGNIFICANT GROWTH IN THE SMALL BUSINESS INVESTMENT COMPANY PROGRAM, THE CREATION OF A VITAL ADVOCACY FUNCTION, AND INVOLVEMENT IN AN EXPANDED DISASTER LOAN PROGRAM TO MEET THE NEEDS OF FARMERS. YES, AND DURING THIS SAME 10-YEAR PERIOD, SBA TOOK ON THE SBG PROGRAM. IN EFFECT, WE HAVE SEEN A TREMENDOUS GROWTH IN THE ACTIVITIES AND INFLUENCE OF THE SBA, ALL OF WHICH HAVE BEEN RESOURCE CONSUMING.

WHEN WE CONSIDER THE FACT THAT, WITH ALL THESE ADDED COMMITMENTS, SBA HAD MORE FULL-TIME PERSONNEL IN 1970 THAN IT DOES TODAY, IS IT REALLY A SHOCK THAT SOME PROGRAMS HAVE NOT BEEN AFFORDED THE TYPE OF MANAGEMENT ATTENTION NECESSARY TO AVOID FRAUD, ABUSE, WASTE, AND MISMANAGEMENT? THIS IS NOT MEANT TO SUGGEST THAT BY MERELY THROWING MORE PEOPLE INTO A PROGRAM WE WILL NECESSARILY ACHIEVE BETTER PROGRAM PERFORMANCE. BY THE SAME TOKEN, ANY EFFORT TO EFFECTIVELY MANAGE AN EVER-BURGEONING WORKLOAD CALLING FOR THE DEVELOPMENT OF EXPERTISE AND SOPHISTICATION IN A NUMBER OF DIVERSE AREAS AT A TIME WHEN RESOURCES REMAIN CONSTANT OR ARE SHRINKING, IS AN OPEN INVITATION TO SOME OF THE PROBLEMS WE HAVE SEEN.

SOME OF THE PROBLEMS WE SEE TODAY IN THE SBG PROGRAM CAN BE TRACED TO SOME EXTENT TO A SHORTAGE OF COMPETENT, WELL-TRAINED PERSONNEL DURING ITS PLANNING, DEVELOPMENT, AND IMPLEMENTATION STAGES AND TO AN OVERDELEGATION OF DISCRETION TO SURETIES, WHICH IN SOME CASES, HAS WORKED TO OUR DETRIMENT. TO THIS DAY, THE PROGRAM HAS ONLY ONE EMPLOYEE WITH ANY PREVIOUS SURETY BOND EXPERIENCE. AS EXAMPLES OF WHAT WE HAVE SEEN IN SBA GENERALLY AND IN THIS PROGRAM SPECIFICALLY, I WOULD ASK THE COMMITTEE TO CONSIDER THE FOLLOWING FACTS:

- AT THE END OF FISCAL YEAR 1972, SBA HAD WRITTEN 1,339 CONTRACT BONDS HAVING A VALUE OF $94 MILLION. THE PROGRAM THEN HAD 36 PERSONNEL ASSIGNED TO IT.

- DURING FISCAL YEAR 1981 ALONE, NEARLY 18,000 CONTRACT BONDS CARRYING GUARANTEES TOTALLING $1.6 BILLION HAD BEEN WRITTEN. AT THAT TIME, THERE WERE A TOTAL OF 51 PROGRAM PERSONNEL, 17 OF WHOM WERE PART-TIME EMPLOYEES. IN EFFECT, THE PROGRAM HAS EXPERIENCED A 15-FOLD INCREASE IN BONDING ACTIVITY, AND A COMMENSURATE INCREASE IN DEFAULT RELATED CLAIMS ACTIVITY, WHILE GAINING ONLY 15 PERSONNEL.

- OVER AN 11-YEAR HISTORY, MORE THAN 8,000 BONDS HAVE GONE INTO DEFAULT AND CLAIMS PAYMENTS ON A LITTLE OVER 7,000 OF THESE BONDS HAS EXCEEDED $178 MILLION. THESE CLAIMS HAVE BEEN PROCESSED BY A CENTRAL OFFICE STAFF WHICH HAS HAD TO RELY, TO A SIGNIFICANT EXTENT, ON PART-TIME CLAIMS PROCESSORS. BEAR IN MIND THAT THESE CLAIMS REPRESENT LITERALLY THOUSANDS OF PIECES OF PAPER AS A RESULT OF THE CUMULATIVE EFFECTS OF DEFAULTS OVER THE 11 YEARS.

- AT THE PRESENT TIME, THE CENTRAL OFFICE CLAIMS REVIEW STAFF CONSISTS OF 18 PERSONNEL, INCLUDING 5 WHO ARE PART-TIME COLLEGE STUDENTS WITH ABSOLUTELY NO CLAIMS EXPERIENCE, WHO ARE PROCESSING AND PAYING MILLIONS OF DOLLARS IN CLAIMS EACH YEAR. THEY PAY ON AN HONOR SYSTEM WITH NO QUESTIONS ASKED AND THE SURETIES KNOW THAT THE CHANCES OF A SPOT CHECK BY SBA ARE VIRTUALLY NON-EXISTENT.

WHEN THESE FACTORS ARE NOTED, MR. CHAIRMAN, AND THEN CONSIDER THE MANAGEMENT RECORD OF THE SBG PROGRAM, ONE CANNOT HELP BUT CONCLUDE THAT THE SBA JUST DOES NOT HAVE THE PRESENT ABILITY TO PROVIDE HIGH QUALITY SERVICE TO THE SMALL BUSINESS COMMUNITY. I THINK THE SBG PROGRAM IS A PERFECT EXAMPLE OF WHAT CAN OCCUR WHEN ADEQUATE, COMPETENT, AND WELL-TRAINED STAFFING IS NOT MADE AVAILABLE TO A PROGRAM OF THIS SCOPE AND COMPLEXITY.

IT SEEMS THAT WE HAVE COME TO THE POINT WHERE SOME DIFFICULT DECISIONS WILL HAVE TO BE MADE ABOUT SBA'S PRIORITIES FOR THE FUTURE. WE MUST DECIDE WHAT PROGRAMS AND SERVICES ARE ESSENTIAL TO SMALL BUSINESS AND REALIGN EXISTING RESOURCES TO CONFORM TO THESE DECISIONS. SUCH DECISIONS MAY WELL INVOLVE LEGISLATIVE ACTION. WHERE APPROPRIATE, SBA SHOULD CONSIDER DELEGATING TO OR CONTRACTING WITH THE PRIVATE SECTOR TO EXPAND ITS INVOLVEMENT IN AREAS DESIGNED TO AID SMALL BUSINESS. UNDOUBTEDLY, ANY EFFORT TO CONSOLIDATE AND REALIGN WILL REQUIRE SOME INNOVATIVE AND CREATIVE APPROACHES TO GETTING THE JOB DONE.

IF THIS EVALUATIVE PROCESS RESULTS IN A DECISION TO CONTINUE AN ACTIVE SBG PROGRAM, THEN IT OUGHT TO BE GIVEN ADEQUATE RESOURCES, SOUND INTERNAL CONTROLS, POLICIES AND PROCEDURES SHOULD BE ESTABLISHED, AND MANAGEMENT SHOULD BE HELD STRICTLY ACCOUNTABLE FOR RESULTS. SINCE THE PROGRAM DOES RELY HEAVILY ON SUPPORT FROM THE PRIVATE SECTOR SURETIES, ANY EFFORT TO SOUNDLY MANAGE OUR END OF THE PROGRAM SEEMINGLY WOULD ENHANCE OUR ABILITY TO ATTRACT MORE OF THE EXPERIENCED SURETIES TO THE PROGRAM AND RESULT IN A MORE CREDIBLE, COST-EFFECTIVE PROGRAM FOR SMALL BUSINESS.

WITH THAT, MR. CHAIRMAN, LET ME REVIEW WHAT SHOULD BE CONSIDERED BY WAY OF MANAGEMENT ACTION ON THE PART OF THE SBA; USING AS A POINT OF REFERENCE OUR APRIL 1981 AUDIT REPORT AND ITS RECOMMENDATIONS. WE WOULD NOTE THAT CERTAIN STEPS HAVE BEEN TAKEN BY A NEW SBG PROGRAM MANAGEMENT TEAM ON THE JOB SINCE SEPTEMBER 1980 TO ADDRESS SOME OF THE PROGRAMS PROBLEMS. I BELIEVE THE ACTING ADMINISTRATOR WILL GIVE TESTIMONY ON THIS SUBJECT AND ALSO OFFER RECOMMENDATIONS OF HIS OWN FOR THE SBG PROGRAM:

1. VIRTUALLY EVERY AUDIT ORGANIZATION WHICH HAS REVIEWED THE SBG PROGRAM HAS RAISED CONSIDERABLE CONCERN OVER THE STANDARDS FOR EVALUATING, UNDERWRITING AND GUARANTEEING BONDS. AS THE PROGRAM IS CURRENTLY STRUCTURED, WITHOUT SOME FORM OF GUIDELINES THE SURETY INDUSTRY CANNOT BE HELD TO ANY CONSISTENT STANDARDS AND SBA PROGRAM OFFICIALS HAVE NO ABILITY TO ASSESS PROPOSALS FOR A BOND GUARANTEE.

2. SBA HAS DEVELOPED NO PROFILE OF THE CLAIMS VERIFICATION AND PROCESSING SYSTEMS USED BY ITS SURETIES AND UNDERWRITERS. A REVIEW OF THESE PROCEDURES AND THE DEVELOPMENT OF SOME UNIFORM PROCESS FOR THE HANDLING OF CLAIMS, THE DOCUMENTATION REQUIRED TO SUPPORT CLAIMS, AND A DEFINITION OF THOSE CHARGES WHICH ARE REIMBURSABLE UNDER THE CONTRACT IS ESSENTIAL. BASED ON OUR AUDIT EXPERIENCE, WE HAVE A PARTICULAR CONCERN OVER THE NATURE AND SCOPE OF LEGAL AND OTHER FEES WHICH CAN BE CHARGED TO SBA AS A REASONABLE AND PROPER EXPENSE ASSOCIATED WITH THE CLAIMS PROCESS. I AM ADVISED THAT SBA HAS RECENTLY TAKEN STEPS TO ADDRESS THESE MATTERS.

WE WOULD SUGGEST THAT BEFORE ANY SUBSTANTIVE STEPS ARE TAKEN TO ADDRESS THE UNDERWRITING AND CLAIMS AREA, SBA MIGHT FIND IT HELPFUL TO REVIEW THE PROCEDURES USED BY SOME OF OUR STANDARD AND SPECIALTY COMPANIES WHICH APPEAR TO HAVE COMPILED A GOOD PROGRAM PERFORMANCE RECORD.

3. AT THE PRESENT TIME, SOME SURETIES HAVE VIRTUALLY NO RISK OF LOSS ASSOCIATED WITH THEIR PARTICIPATION IN THE PROGRAM. IN MANY CASES, EVEN THEIR 10 PERCENT SHARE OF ANY LOSS IS PASSED BACK TO THEIR AGENT. WE RECOMMEND CONSIDERATION OF SOME FORM OF A SLIDING SCALE OF GUARANTEE FEES BASED ON LOSS RATES INCURRED BY THE SURETY OR ANY OTHER CREATIVE STRUCTURING OF RELATIONSHIPS DESIGNED TO BETTER PROTECT THE INTEREST OF THE SBA AND SURETIES. I BELIEVE THAT PROGRAM OFFICIALS ARE NOW ENGAGED IN DEVELOPING SUCH A PLAN.

4. ONE OF THE RECURRING PROBLEMS ENCOUNTERED BY AUDITORS WHICH ALSO HAMPERS THE ABILITY OF PROGRAM OFFICIALS TO EFFECTIVELY MANAGE THEIR PROGRAMS IS THE LACK OF ACCURATE, TIMELY, AND EASILY RETRIEVABLE MANAGEMENT INFORMATION. THE PROBLEM IS SIGNIFICANT IN THE SBG PROGRAM. PROGRAM OFFICIALS HAVE INFORMED US THAT THERE ARE 26 SEPARATE COMPUTER REPORTS WHICH ARE PREPARED MONTHLY, QUARTERLY, OR ANNUALLY. THEY HAVE ALSO STATED THAT THEY CONSIDER THESE REPORTS TO BE OF LITTLE, IF ANY VALUE, TO THEM. OUR OWN EXPERIENCE WITH THESE REPORTS GIVES US NO CAUSE TO TAKE ISSUE WITH THIS ASSESSMENT.

UNTIL RECENTLY, WHEN AN OIG INVESTIGATOR MANUALLY REVIEWED NUMEROUS ITEMS OF INFORMATION, NEITHER THE OIG NOR PROGRAM OFFICIALS HAD ANY REAL GAUGE OF THE DEFAULT EXPERIENCE OF VARIOUS SURETIES, THEIR AVERAGE CLAIMS SIZE, THE AMOUNT OF RECOVERIES, ETC. SUCH INFORMATION IS SO VITAL TO BASIC PROGRAM MONITORING THAT IT SHOULD BE AUTOMATED AND MAINTAINED FOR REGULAR USE BY PROGRAM OFFICIALS.

5. IN CONNECTION WITH ANY EFFORT TO EVALUATE THE PERFORMANCE OF OUR SURETIES, ONE OF THE RECOMMENDATIONS MADE BY THIS OFFICE RELATES TO THE MANNER IN WHICH SBA HAS TRADITIONALLY COMPUTED ITS LOSS RATES IN THE SBG PROGRAM. WE ENCOUNTERED CONSIDERABLE RESISTANCE, AND UNDERSTANDABLY SO I MIGHT ADD, WHEN WE SUGGESTED THAT SBA ENDEAVOR TO MONITOR PROGRAM LOSS RATES USING A SYSTEM COMPARABLE TO THE PRIVATE SECTOR. IN OUR VIEW, SUCH A SYSTEM WOULD PROVIDE A VALUABLE ANALYTICAL TOOL TO THESE MANAGERS.

IN THE PRIVATE SECTOR, LOSSES ARE THE RATIO OF PREMIUM DOLLARS RECEIVED AS AGAINST CLAIMS PAID. I AM ADVISED THAT A 40 CENT ON THE DOLLAR--OR 40 PERCENT LOSS RATE--IS ACCEPTABLE TO SURETY COMPANIES.

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OVER THE YEARS, SBA HAS COMPUTED ITS LOSSES BY COMPARING THE TOTAL VALUE OF BONDS WRITTEN WITH THE AMOUNT OF MONEY PAID ON CLAIMS. ONE CAN READILY SEE THAT THIS IS AN APPLES AND ORANGES TYPE COMPARISON. USING THIS FORMULA, ONE WOULD BE LED TO BELIEVE THAT SBA PROGRAM EXPERIENCES SOMETHING LESS THAN A 5 PERCENT LOSS RATE WHEN COMPARED TO SURETIES GENERALLY.

HOWEVER, IF A FORMULA SIMILAR TO THAT USED BY THE STANDARD SURETIES WERE ADOPTED FOR SBA'S ENTIRE PROGRAM, OUR BEST ESTIMATE ON THE BASIS OF AVAILABLE STATISTICS INDICATES THAT PROGRAM LOSSES COULD AMOUNT TO A $2 PAYOUT FOR EVERY DOLLAR OF PREMIUM RECEIVED--OR A 200 PERCENT LOSS RATE. I WOULD HASTEN TO ADD THAT WHILE THIS MAY BE THE CASE, WE MAKE NO JUDGMENT ON WHETHER THE RATE IS EXCESSIVE OR IS APPROPRIATE GIVEN THE NATURE OF THE SBG PROGRAM AND THOSE WHO ARE INTENDED TO BE HELPED BY IT. WHAT WE DO BELIEVE, HOWEVER, IS THAT SBA OUGHT TO KEEP ITS BOOKS IN A MANNER WHICH WILL PRESENT A REASONABLY ACCURATE INDICATOR OF PROGRAM PERFORMANCE AND PERMIT INFORMED ASSESSMENTS AS TO ITS EFFECTIVENESS.

6. THE SBG PROGRAM IS VERY MUCH AKIN TO A COST REIMBURSABLE TYPE CONTRACT. THE COMMITTEE WILL RECALL EARLIER HEARINGS IN WHICH I TESTIFIED AT LENGTH ABOUT DISALLOWED COSTS UNCOVERED BY OUR AUDITS OF THESE TYPES OF CONTRACTS. WE BELIEVE THAT REGULAR CLAIMS REVIEWS BY PROGRAM OFFICIALS COUPLED WITH A SYSTEMMATIC AUDIT BY THE OIG OF CERTAIN CLAIMS CAN HAVE A SALUTARY EFFECT ON THIS PROGRAM. AS NOTED EARLIER, WE NOW PAY CLAIMS ON THE HONOR SYSTEM. THERE IS VIRTUALLY NO RISK OF AN AUDIT OF CLAIMS AND MOST SURETIES AND THEIR AGENTS ARE ACUTELY AWARE OF THIS FACT. PROGRAM MONITORING AND OIG OVERSIGHT, JUST AS IN THE CONTRACTING AREA, ARE A NECESSARY QUALITY CONTROL AND DETERRENT MECHANISM WHICH SHOULD BE ADOPTED FOR THE PROGRAM.

MR. CHAIRMAN, I HAVE ENDEAVORED TO HIGHLIGHT ONLY A FEW OF THE MORE SIGNIFICANT RECOMMENDATIONS WE WOULD OFFER FOR THE CONSIDERATION OF PROGRAM MANAGERS AND INDIVIDUALS MORE EXPERT ON THE ISSUES OF SURETYSHIP THAN THOSE OF US IN OIG. WHAT IS CLEAR TO ME, AS IT IS TO OTHER FEDERAL AND STATE AUDIT ORGANIZATIONS WHICH HAVE EXAMINED THE PROGRAM, IS THAT IT CANNOT CONTINUE TO OPERATE WITHOUT SUBSTANTIAL CHANGES. IF THE FUTURE MANAGEMENT AND DIRECTION OF THE PROGRAM IS NOT TAKEN SERIOUSLY, IF A COMMITMENT IS NOT MADE TO ADDRESS SOME OF THE

SERIOUS DEFICIENCIES REPEATEDLY NOTED AS A RESULT OF THE CONSIDERABLE AUDIT EFFORTS EXPENDED, I AM CONFIDENT THAT WE WOULD REPORT THE SAME FINDINGS TO THIS COMMITTEE IN THE YEARS AHEAD. I THINK WE KNOW WHAT THE PROGRAM PROBLEMS ARE TODAY. I AM HOPEFUL THAT SBA CAN AND WILL DO SOMETHING ABOUT THEM.

IN THAT RESPECT, MR. CHAIRMAN, I WOULD AGAIN LIKE TO ACKNOWLEDGE THE VITAL ROLE PLAYED BY THIS COMMITTEE AND ITS STAFF IN THE IDENTIFICATION AND RESOLUTION OF PROBLEMS OF MUTUAL CONCERN IN THE SURETY BOND GUARANTY PROGRAM. THE COOPERATION AND SUPPORT OF YOU, THE COMMITTEE, AND ITS STAFF IN THIS REGARD HAS BEEN AND WILL CONTINUE TO BE GREATLY APPRECIATED. IN THAT SPIRIT OF COOPERATION, I AM HOPEFUL THAT SBA, THE COMMITTEE AND MY OFFICE CAN BEGIN TO MAKE SIGNIFICANT PROGRESS TOWARDS THE ACCOMPLISHMENT OF NEEDED IMPROVEMENTS IN THE PROGRAM.

THAT CONCLUDES MY PREPARED STATEMENT. I WOULD BE PLEASED TO TRY TO ANSWER ANY QUESTIONS THE COMMITTEE MAY HAVE.

The **Chairman**. The next witness will be Mr. W. E. Douglas, Commissioner of the Bureau of Government Financial Operations, Department of the Treasury.

All right, Mr. Douglas, why don't you proceed? Your statement in its entirety will be placed in the record following your testimony, and you proceed in any way you deem appropriate.

## STATEMENT OF WILLIAM E. DOUGLAS, COMMISSIONER, BUREAU OF GOVERNMENT FINANCIAL OPERATIONS (BGFO), DEPARTMENT OF THE TREASURY, ACCOMPANIED BY KENNETH SCHMALZBACH, BGFO LEGAL COUNSEL; AND MARY CASEY, BGFO STAFF AUDITOR

Mr. **Douglas**. Thank you. Good morning, Mr. Chairman, members of the Oversight Committee.

I am William E. Douglas, Commissioner of the Bureau of Government Financial Operations, Department of the Treasury. I am accompanied by Mr. Kenneth Schmalzbach, BGFO's legal counsel, and Mrs. Mary Casey, a BGFO staff auditor.

Thank you for the invitation to appear today to discuss various aspects of Treasury's listing of companies holding certificates of authority as acceptable sureties on Federal bonds.

Under 6 U.S.C. sections 6-13, the Department of the Treasury has the responsibility for approving corporate sureties wishing to write Federal bonds. Regulations implementing the statute are contained in 31 CFR part 223, and are supplemented by guidelines contained in Treasury's annual letter to surety companies.

In reviewing surety companies' applications for certificates of authority, and subsequent renewals, Treasury assures that the companies satisfy the statutory criteria for acceptability on Federal bonds. These statutory criteria are designed to insure that a company giving a bond has authority to do so, and the financial wherewithal to protect the United States and its subcontractors against financial loss.

The statutory criteria are that the company have authority under its State charter to write bonds to which the United States is a party; that it have paid up capital of $250,000; and that it be able to keep and perform its contracts.

The Secretary is under an express statutory mandate to grant a certificate of authority to a company that meets these criteria.

Similarly, in order for the Secretary to revoke a company's certificate, he must conclude that it no longer satisfies these criteria: That it is insolvent; that it has written a bond to which the United States is a party in a jurisdiction where the company has failed to appoint a process agent; or that it has failed to make required periodic reports to Treasury.

The process of assessing a surety's financial condition begins with the receipt of all data required by Treasury's application package. An auditor evaluates the financial information by applying the criteria outlined in Treasury's regulations and guideline letter. Any supplementary information, such as a report of State examiners, an auditor's report, a 10-K report, biographical sketches of officers and directors, and reinsurance schedules are also reviewed.

The application is then referred to our legal staff for review. Based on reviews of this and any additional information requested, my staff decides to either reject the application or recommend its approval.

If, as a result of the review, we conclude that the surety does not qualify for a certificate, or that it qualifies for an underwriting limitation of less than 10 percent of its reported policyholders' surplus, the results of the review are communicated to the company by letter. The company is permitted to furnish additional documentation or to meet with us to present its views.

After reviewing any additional information submitted, my staff either recommends certification or denies it. In some cases, companies which are denied reapply after making internal changes, such as rearranging their investments or reinsurance operations.

Our procedures for monitoring the financial condition of the sureties and annually renewing their certificates of authority follow along similar lines.

One of our requirements is that qualified companies file quarterly financial reports and schedules of excess risks. The latter form shows how a company protected the risks it wrote in excess of its underwriting limitation.

We review these submissions and if violations of Treasury requirements are found, we require the company to take corrective action within approximately 20 business days.

If the quarterly report indicates the company is experiencing financial difficulties, the company is placed on a monthly reporting basis and monitored closely. If a company's financial condition drops below the requirements specified in the annual letter, we notify the company and begin the termination process.

In the annual review process, an auditor reviews the material submitted in accord with Treasury's guideline letter and makes a tentative determination as to whether the company continues to meet the Treasury's requirements. If we determine that the requirements are met, the company's certificate is renewed by a letter which sets forth its new underwriting limitation. The company is given an opportunity to submit additional material if it disagrees with the underwriting limitation.

If our review causes us to conclude that a company is no longer qualified, or that there is doubt as to its solvency or ability to keep and perform its contracts, the company is notified. If the problem can be corrected by the company by obtaining additional capital or making other arrangements, the company is normally given a fairly short period of time, usually 20 to 60 days, to do so.

I have outlined the policies and procedures we follow in implementing our statutory mandate. I would be pleased to answer any questions which you may have at this time.

The CHAIRMAN. In your response to my letter dated October 29, 1980, you indicated that you would continue your contact with Mr. Boucher to obtain further information regarding IFI. In addition, you stated, "I am not in a position at this time to tell you what the results of this coordinated authority may be." First, what were your coordinated efforts with the I.G. after sending me this letter and, second, what were the results? (See exhibit IVc beginning at p. 463.)

Mr. Douglas. We met. We had both our legal counsel and our audit staff managers, meet with Mr. Boucher and get information from him, and subsequent to that we had a number of contacts between our audit staff that handles surety bonds and the investigators of SBA.

No information that we received from them was of a nature that would allow us to take action against IFF.

The Chairman. Well, I sent you a rather complete letter on this matter and asked for a response insofar as IFI was concerned. It's my understanding that aside from the letter that you wrote to me in response, there has been no substantive investigation of IFI, or, indeed, very much further in the way of contact with the I.G.'s Office at SBA. Is that correct? (See exhibit IVd beginning at p. 465.)

Mr. Douglas. That's not my information, Senator. We have had a number of contacts with them, some as recently as 2 months ago. However, we have not received any information from them which would allow us to remove the company, which is the request that you made.

The Chairman. Well, I asked that an independent investigation be conducted. Was it conducted or not?

Mr. Douglas. We did make a review, not only of IFI, but also of our procedures, as you requested, and the conclusion that we reached was that we have no basis, given the information available to us now, to remove that company.

The Chairman. The committee has reviewed information that shows IFI has a loss rate of 86.6 percent on its surety business. That is, for every dollar received, IFI loses 86 cents. Do losses of this magnitude concern the Bureau?

Mr. Douglas. It would if it would have had an effect on its overall financial standing, but it does not, has not had that effect. The financial information that is available to us indicates it does not, and in fact it is my understanding that Best gives them an A rating.

Senator Rudman. Mr. Chairman, would you yield just for one moment?

The Chairman. Sure. Go right ahead.

Senator Rudman. I just listened to that answer a little incredulously. I mean, of course, it doesn't have any effect on them. Ninety percent of it is paid by Uncle Sam. I mean, if you have a business operating and the business loses $100,000 a year, and you've got some sort of a rich uncle that puts in $97,000 worth of new capital every year, then you can say, "Well, the business isn't doing too badly. It only loses $3,000 a year." Is that essentially what you're saying here?

Mr. Douglas. I'm saying that our ability to either place a company or remove a company from the approved list, Senator, is based on their financial stability and their record of keeping their contracts.

Senator Rudman. Mr. Douglas, you don't wear blinders when you do that. I mean, I've got 6 U.S. Code in front of me, and I think I read the law probably as well as most. You have some latitude.

You have a situation here in which you've got underwriting losses of 86 percent which, with a normal company, would put them right down the tube, and you have to recognize that the reason that they're still surviving is not because they're stable, but because Uncle Sam is reimbursing 90 percent. Are you telling me that you don't think you can take that into consideration in determining financial viability?

Mr. DOUGLAS. The fact that they are filing claims with SBA and being reimbursed?

Senator RUDMAN. The fact that 90 percent of the losses that they're sustaining across the board in many cases are SBA claims, and that's really why they're still viable. You don't think you can look at that?

Mr. DOUGLAS. Senator, it seems to me that the problem is in their relationship with SBA. You're asking us to remove them because they're not financially sound, when all the data which we get and which we look at indicates that they are. The law is very, very narrow on that point.

The CHAIRMAN. Now, what Senator Rudman is saying is that without the 90 percent guarantee, they would not be financially sound.

Mr. DOUGLAS. I understand that, Senator.

The CHAIRMAN. Now, believe me, aside from the disparaging comments that people make about their own government, I believe the Government of the United States is sound. I don't think you have to pass upon that at Treasury. I'll accept that. That's all we're talking about, though. Without that, this company would not meet anybody's financial criteria.

Mrs. CASEY. It is possible that, in looking at the company, if they were not participating in SBA's program, they would not be having these losses. We cannot say that they would be insolvent if they were not in SBA's program. I cannot determine from what their losses are occurring, whether much of their losses are from the SBA program or whether it's from other bonds or policies that they are writing.

Now, it is possible that they would not be having these underwriting losses. I'm not making a comment on SBA's program. What I'm trying to point out is that we cannot say that they would be having the same underwriting results if they were not in SBA's program.

The CHAIRMAN. Well, counsel tells me all of IFI's surety business is SBA-guaranteed. All of it.

Mrs. CASEY. Okay.

The CHAIRMAN. And if you can't make that determination, then how can you make the determinations that you have to make under the U.S. Code?

Mrs. CASEY. We review the company's financial statement, and we apply industry ratios, and our complete financial review looks at their assets, the company's liquidity, and if their losses are being reimbursed and they're guaranteed under SBA, I cannot say that we can remove them for that reason.

The CHAIRMAN. Now, I asked—regardless of what the law imposes upon you, I asked a specific question of Treasury.

"Dear Commissioner Douglas: Today the Senate"—this is September 25, 1980—"Senate Select Committee on Small Business received testimony from the Small Business Administration's Inspector General, Paul Boucher, in which it was revealed that during the course of an investigation by his office, it was discovered that as of August 1980, approximately 48 percent of International Fidelity Insurance Co.'s stock is owned by known organized crime figures or associates thereof, or by companies partially controlled by such individuals. This insurance company is currently listed by the Department of Treasury as a surety company acceptable on Federal bonds. Based upon the testimony presented at our hearing, I request that you immediately remove the International Fidelity Insurance Co. from your list of surety companies acceptable on Federal bonds until further review by your agencies. I further request that you immediately commence a full-scale investigation to determine how effective your procedures and guidelines are for certifying companies on this list. I would also expect that, based upon what the Small Business Administration's Inspector General found in one company, you should re-examine each company now listed to determine the validity of the company's certification."

Now, I want to know whether that was done.

Mr. Douglas. Yes, sir.

The Chairman. Or whether it just resulted in a letter from you to me and a couple of inquiries of SBA, of contacts with SBA? Was there a full investigation done as a result of this?

Mr. Douglas. We did a full review of IFI, Senator. In addition to that, we looked at the statute. We involved not only our legal people—we looked at the point where you said a criminal background was involved. There is nothing in our statute which prohibits someone with a criminal background from doing surety bond business, and indeed we went to the Department of Justice, to the Organized Crime Section, and asked them if there was any statute which would bar this company, if these allegations were proved, from doing business, and the answer we got was that they knew of none.

The Chairman. Your annual recertification report requires that a company provide Treasury with a copy of any State insurance examination.

Mr. Douglas. That is correct.

The Chairman. I gather, then, you rely upon that information to some extent, at least, in making a judgment about a company seeking recertification on your list, is that correct?

Mr. Douglas. We do.

The Chairman. And when were you aware of the various states that had denied certification?

Mr. Douglas. To IFI?

The Chairman. Yes.

Mrs. Casey. You are referring to American Fidelity Fire here?

Mr. Douglas. I don't believe IFI has been denied, at least not——

The Chairman. IFI has not been denied certification?

Mrs. Casey. Well, we have not been informed, if they have.

Mr. Douglas. We have not been informed if they have, Senator.

The Chairman. What about AFFI?

Mrs. **Casey**. When we were informed or received information that American Fidelity Fire was delicensed, I called that day to the four States that I was informed of and spoke with their licensing departments.

The **Chairman**. Who informed you, by the way, of that?

Mrs. **Casey**. I talked with a representative from SBA.

The **Chairman**. When were you informed of that?

Mrs. **Casey**. That was 2 weeks ago, approximately.

The **Chairman**. I see.

Mrs. **Casey**. I don't have the exact date. It was approximately 2 to 3 weeks ago. It might even have been 1 month ago. But, anyway, upon hearing that they had been delicensed, I called that day to the licensing department of the four states and was informed that, yes, the company was licensed to transact surety business.

After making those phone calls, I called back to SBA, and they informed me that they had talked with the Senate investigators. So I called to the Senate investigators and asked them where they had obtained their information.

After talking with them, I then sent out written notifications to the four States involved. I have received three replies back. They have stated that the companies are restricted, but not delicensed. I am still following up on other States.

The **Chairman**. As far back as 1973, New Hampshire denied AFFI its application for readmission to operate within that State because of AFFI's financial situation and poor record in handling claims.

November 29, 1976, the State of Connecticut restricted all of AFFI's lines of business within that State, and the State has not permitted AFFI to either solicit new business or renew any business.

April 26, 1978, the State of Hawaii rejected AFFI's application for admission because that company showed adverse test results as reported in the National Association of Insurance Commissioners Early Warning System. (See exhibit IVe beginning at p. 466.)

Since September 6, 1978, AFFI has been prohibited from transacting business in Massachusetts, quote, "due to its financial condition, operating results, and failure to make timely reports." (See exhibit IVf beginning at p. 467.)

Fifth, the State of Georgia has informed me that as far back as 1967, this department was concerned over the continued unfavorable underwriting experience of this company, and in 1976 Georgia placed several restrictions upon AFFI's operation in that State. (See exhibit IVg beginning at p. 468.)

Now, is that enough to go ahead and alert Treasury that maybe they shouldn't be on Treasury's approved list?

Mr. **Douglas**. This is AFFI, you're speaking of?

The **Chairman**. This is AFFI.

Mr. **Douglas**. We have them on monthly reporting at this time, Senator, and are looking closely at their financial condition, but their condition has not been such that they can be removed.

Mrs. **Casey**. We've had them on a monthly reporting basis since 1978, and their condition has started improving. At no time were they below the requirements, so that we could remove them from our list. We have been in close contact with them, monitoring their condition.

The CHAIRMAN. Do you think when the statute states that an insurance company must, quote, "be able to keep and perform its contracts," there is an implication in there as to the fact that they would do so within the law? I mean, I think there is some sort of an implication of that, don't you? Do you think it gives you any leeway under that provision of the Code?

Mr. DOUGLAS. That they would keep and perform?

The CHAIRMAN. Yes, within the law.

Mr. DOUGLAS. I would say that if you allowed some area for dispute, which goes on, I understand, frequently, but that once, for example, a judgment is rendered that they then meet their commitment. That would be——

The CHAIRMAN. Well, I mean, we've heard incident after incident from the Inspector General relating to both these companies.

I'll tell you what I think, and I'm sorry to pass judgment in this fashion, but this is the second time around the boards with you people from Treasury. I think you've got some bureaucrats there who just want to do the least possible. And I'll tell you who is getting ripped off. It is the American public. Now, don't tell me you don't have the capacity to get in there and afford some protection. I think you do, and I don't think you've responded to my request of almost 2 years ago, except in the most perfunctory way.

I'm not putting all the blame on the Treasury. The Inspector General has already indicated SBA itself is to blame in large measure. But the bottom line result of all of this is that millions and millions of dollars are knowingly—knowingly—being turned over to persons who in some instances I clearly think are on the other side of the law, and in many more instances are right on that line. Although I'm not in a position to make that determination, somebody should be.

I think Warren can probably speak to this better than I can. However, I believe it would be very difficult to get convictions in these cases, because, to my way of thinking, the U.S. Government—whether its Treasury or SBA—is walking into this situation with their eyes wide open and saying, "It's OK." I should think that would be a real problem.

Senator RUDMAN. I have one question, please.

The CHAIRMAN. Go right ahead.

Senator RUDMAN. Could you tell us from your recent memory how often or how many companies you refused to put on your list or that you've denied?

Mr. DOUGLAS. Probably over the last 7 or 8 years, perhaps about 40——

Mrs. CASEY. No, that's terminations.

Mr. DOUGLAS [continuing]. terminations that we've taken off the list.

Mrs. CASEY. May I speak to that one?

Mr. DOUGLAS. Surely.

Senator RUDMAN. Have you had any appeals?

Mrs. CASEY. Yes, may I speak to that one, please?

Senator RUDMAN. Yes, if you can pull the microphone over, it would be easier to hear you.

Mrs. CASEY. In our review of the applications, in this past year we have rejected approximately four applications based on financial condition. The companies in most cases do appeal it, and will come back in with additional material, or else they will have surplus contributed to the company to improve their condition.

I would say out of those four rejected, one was able to obtain additional surplus to the company that enabled them to meet our requirements.

Senator RUDMAN. Well, let me put it another way. Have you had any of your final decisions appealed on the basis that they were arbitrary and capricious and had them overturned?

Mrs. CASEY. No, sir.

Senator RUDMAN. Are you going to tell this committee this morning that if you had denied, under the general wording of the jurisdiction of United States Code 6, with the paragraphs as they exist, do you want the evidence before the committee this morning to be that had you denied or delisted either of these companies the right to do business with the Federal Government, that they could have successfully appealed that kind of a ruling? Is that your legal opinion?

Mr. DOUGLAS. Senator, I think that is our opinion, that they would be successful. Yes.

Mrs. CASEY. They were still meeting our financial requirements. The rejections of the applications I'm referring to were for financial matters.

Senator RUDMAN. Even though a court could look at the fact that all of the surety business of AFF was done with the Federal Government, and that the reason that they were in a reasonably healthy financial condition was because the reimbursements were running at 90 percent? Even with that evidence before a court, it's your belief that a court would say that your action would be arbitrary and capricious?

Mr. DOUGLAS. It is.

Senator RUDMAN. Well, I'll tell you something, when I was attorney general of the State of New Hampshire, if I'd had that kind of philosophy, we would have had people running amuck, committing fraud all over the State.

Occasionally, you know, you have to shoot and ask questions later, and I'm talking about lawyers. I think that's a very timid approach. I disagree with you, and I'm going to suggest to the chairman that we get to the appropriate Committee and we toughen up the language so that maybe we can give people a little bit more courage down there. That's what I think.

The CHAIRMAN. Mr. Douglas, your Bureau informed my staff just last week that they were unable to confirm that AFFI was restricted or delicensed in the various States that I have mentioned earlier. Now, if you can't confirm that kind of simple information, how can we—or how can you expect us to believe that your department is monitoring the firms on the Treasury surety list?

Mrs. CASEY. May I ask what this is in reference to?

The CHAIRMAN. This is in reference to the various information coming forth from the States of New Hampshire, Connecticut, Hawaii, Massachusetts, and Georgia.

Mrs. **Casey**. We just started receiving our confirmations from the States of Georgia, Illinois, and one other State in the middle of last week. We are just getting that information. We're not trying to obstruct any information.

The **Chairman**. Why shouldn't you have had it earlier on, if from no other point, from the point of my letter to you asking you to check your whole list over 1 year ago?

Mr. **Douglas**. Senator, are we confusing IFF and AFF?

The **Chairman**. No; we're not. I didn't restrict that letter to—what was the last part of that letter to you? "You should re-examine each company on the list to determine the validity of the company's certification."

Mr. **Douglas**. We do that, Senator. We do it every year.

The **Chairman**. Even with that kind of information from the various States?

Mr. **Douglas**. We do not canvass every State on every company.

The **Chairman**. Well, again, we're not talking about a matter of no consequence. Clearly, indeed, you have been in contact with the Inspector General and this committee. Over 1 year ago, the red flags were flying as to both these companies.

Again, I can assure you that the committee will take action. I think the suggestions made by Mr. Rudman make sense.

But I really worry as to how vigorously you're protecting the taxpayers of this country over there, and I feel that you're just sort of going through the motions.

Mr. **Douglas**. Senator, we are not going through the motions, but we also are not going beyond the bounds of the statute which authorizes us in this area.

The **Chairman**. But, to be able to make a determination that company keeps and perform its contracts, believe me, gives you a great deal of leeway.

Is this the advice your counsel is giving? What are you trying to do, hang onto a job there, instead of getting this agency out there in a protective sense? That's what the Treasury Department is for.

I think this is inexcusable, given the information that was laid before you, both by this committee and by the Inspector General of SBA over 1 year ago. You're doing exactly now what you did then—even with monumental evidence presented to you that millions and millions of dollars are getting into the wrong hands and that the Government is being defrauded.

Don't tell me that you don't have authority under the Code. You do.

Mrs. **Casey**. I would like to speak to one point.

The **Chairman**. When it's pointed out that a company would be experiencing serious financial difficulties were were it not for the 90-percent guarantee of the U.S. Government, the dumbest cluck in the world would realize that a company is having a tough situation—and we're talking about the surety bond business now—when indeed it's losing 86 cents out of every dollar. I mean, I cannot comprehend what is required to make you take some action.

What is required to make you act? Tell me.

Mr. **Douglas**. A violation of the statute which we have to operate under.

Senator, SBA does not have to use this company, whether they're on the list or not.

The **Chairman**. I'm not here to absolve SBA, and neither is the Inspector General. Obviously, there is malfeasance going on over there.

But your operation—we might as well have no operation over at the Treasury Department. Maybe we can go ahead and save a little time and a little money over there. It's worthless, in light of the results.

I have further questions that shall be submitted for response to the record.

[The prepared statement of Mr. Douglas and subsequent information follow:]

GOOD MORNING, MR. CHAIRMAN AND MEMBERS OF THE OVERSIGHT COMMITTEE. I AM WILLIAM E. DOUGLAS, COMMISSIONER OF THE BUREAU OF GOVERNMENT FINANCIAL OPERATIONS (BGFO), DEPARTMENT OF THE TREASURY. I AM ACCOMPANIED BY MR. KENNETH SCHMALZBACH, BGFO'S LEGAL COUNSEL, AND MRS. MARY CASEY, A BGFO STAFF AUDITOR.

THANK YOU FOR THE INVITATION TO APPEAR TODAY TO DISCUSS VARIOUS ASPECTS OF TREASURY'S LISTING OF COMPANIES HOLDING CERTIFICATES OF AUTHORITY AS ACCEPTABLE SURETIES ON FEDERAL BONDS.

UNDER 6 U.S.C. SECTIONS 6-13, THE DEPARTMENT OF THE TREASURY HAS THE RESPONSIBILITY FOR APPROVING CORPORATE SURETIES WISHING TO WRITE FEDERAL BONDS. REGULATIONS IMPLEMENTING THE STATUTE ARE CONTAINED IN 31 CFR PART 223 AND ARE SUPPLEMENTED BY GUIDELINES CONTAINED IN TREASURY'S ANNUAL LETTER TO SURETY COMPANIES.

IN REVIEWING SURETY COMPANIES' APPLICATIONS FOR CERTIFICATES OF AUTHORITY, AND SUBSEQUENT RENEWALS, TREASURY ASSURES THAT THE COMPANIES SATISFY THE STATUTORY CRITERIA FOR ACCEPTABILITY ON FEDERAL BONDS. THOSE STATUTORY CRITERIA ARE DESIGNED TO ASSURE THAT A COMPANY GIVING A BOND HAS AUTHORITY TO DO SO AND THE FINANCIAL WHEREWITHALL TO PROTECT THE UNITED STATES AND ITS SUBCONTRACTORS AGAINST FINANCIAL LOSS. THE STATUTORY CRITERIA ARE THAT THE COMPANY HAVE AUTHORITY UNDER ITS STATE CHARTER TO WRITE BONDS TO WHICH THE UNITED STATES IS A PARTY; THAT IT HAVE PAID-UP CAPITAL OF $250,000; AND THAT IT BE ABLE TO KEEP AND PERFORM ITS CONTRACTS. THE SECRETARY IS UNDER AN EXPRESS STATUTORY MANDATE TO GRANT A CERTIFICATE OF AUTHORITY TO A COMPANY THAT MEETS THOSE CRITERIA. SIMILARLY, IN ORDER FOR THE SECRETARY TO REVOKE A COMPANY'S CERTIFICATE, HE MUST CONCLUDE THAT IT NO LONGER SATISFIES THOSE CRITERIA; THAT IT IS INSOLVENT; THAT IT HAS WRITTEN A BOND TO WHICH THE UNITED STATES IS A PARTY IN A JURISDICTION WHERE THE COMPANY HAS FAILED TO APPOINT A PROCESS AGENT; OR THAT IT HAS FAILED TO MAKE REQUIRED PERIODIC REPORTS TO TREASURY.

THE PROCESS OF ASSESSING A SURETY'S FINANCIAL CONDITION BEGINS WITH THE RECEIPT OF ALL DATA REQUIRED BY TREASURY'S APPLICATION PACKAGE. AN AUDITOR EVALUATES THE FINANCIAL INFORMATION BY APPLYING THE CRITERIA OUTLINED IN TREASURY'S

REGULATIONS AND GUIDELINE LETTER. ANY SUPPLEMENTARY INFORMATION SUCH AS A REPORT OF STATE EXAMINERS, AN AUDITOR'S REPORT, A 10-K REPORT, BIOGRAPHICAL SKETCHES OF OFFICERS AND DIRECTORS, AND REINSURANCE SCHEDULES, IS ALSO REVIEWED. THE APPLICATION IS THEN REFERRED TO OUR LEGAL STAFF FOR REVIEW.

BASED ON REVIEWS OF THIS AND ANY ADDITIONAL INFORMATION REQUESTED, MY STAFF DECIDES TO EITHER REJECT THE APPLICATION OR RECOMMEND MY APPROVAL.

IF, AS A RESULT OF THE REVIEW, WE CONCLUDE THAT THE SURETY DOES NOT QUALIFY FOR A CERTIFICATE, OR THAT IT QUALIFIES FOR AN UNDERWRITING LIMITATION OF LESS THAN 10% OF ITS REPORTED POLICYHOLDERS' SURPLUS, THE RESULTS OF THE REVIEW ARE COMMUNICATED TO THE COMPANY BY LETTER. THE COMPANY IS PERMITTED TO FURNISH ADDITIONAL DOCUMENTATION OR TO MEET WITH US TO PRESENT ITS VIEWS. AFTER REVIEWING ANY ADDITIONAL INFORMATION SUBMITTED, MY STAFF EITHER RECOMMENDS CERTIFICATION OR DENIES IT. IN SOME CASES, COMPANIES WHICH ARE DENIED REAPPLY AFTER MAKING INTERNAL CHANGES SUCH AS REARRANGING THEIR INVESTMENTS OR REINSURANCE OPERATIONS.

OUR PROCEDURES FOR MONITORING THE FINANCIAL CONDITION OF THE SURETIES AND ANNUALLY RENEWING THEIR CERTIFICATES OF AUTHORITY FOLLOW ALONG SIMILAR LINES:

ONE OF OUR REQUIREMENTS IS THAT QUALIFIED COMPANIES FILE QUARTERLY FINANCIAL REPORTS AND SCHEDULES OF EXCESS RISKS. THE LATTER FORM SHOWS HOW A COMPANY PROTECTED THE RISKS IT WROTE IN EXCESS OF ITS UNDERWRITING LIMITATION. WE REVIEW THESE SUBMISSIONS AND IF VIOLATIONS OF TREASURY REQUIREMENTS ARE FOUND, WE REQUIRE THE COMPANY TO TAKE CORRECTIVE ACTION WITHIN APPROXIMATELY 20 BUSINESS DAYS. IF THE QUARTERLY REPORT INDICATES THE COMPANY IS EXPERIENCING FINANCIAL DIFFICULTIES, THE COMPANY IS PLACED ON A MONTHLY REPORTING BASIS AND MONITORED CLOSELY. IF A COMPANY'S FINANCIAL CONDITION DROPS BELOW THE REQUIREMENTS SPECIFIED IN THE ANNUAL LETTER, WE NOTIFY THE COMPANY AND BEGIN THE TERMINATION PROCESS.

IN THE ANNUAL REVIEW PROCESS, AN AUDITOR REVIEWS THE MATERIAL SUBMITTED IN ACCORD WITH TREASURY'S GUIDELINE LETTER AND MAKES A

TENTATIVE DETERMINATION AS TO WHETHER THE COMPANY CONTINUES TO MEET THE TREASURY'S REQUIREMENTS. IF WE DETERMINE THAT THE REQUIREMENTS ARE MET, THE COMPANY'S CERTIFICATE IS RENEWED BY A LETTER WHICH SETS FORTH ITS NEW UNDERWRITING LIMITATION. THE COMPANY IS GIVEN AN OPPORTUNITY TO SUBMIT ADDITIONAL MATERIAL IF IT DISAGREES WITH THE UNDERWRITING LIMITATION.

IF OUR REVIEW CAUSES US TO CONCLUDE THAT A COMPANY IS NO LONGER QUALIFIED, OR THAT THERE IS DOUBT AS TO ITS SOLVENCY OR ABILITY TO KEEP AND PERFORM ITS CONTRACTS, THE COMPANY IS NOTIFIED. IF THE PROBLEM CAN BE CORRECTED BY THE COMPANY BY OBTAINING ADDITIONAL CAPITAL OR MAKING OTHER ARRANGEMENTS, THE COMPANY IS NORMALLY GIVEN A FAIRLY SHORT PERIOD OF TIME --20-60 DAYS-- TO DO SO.

I HAVE OUTLINED THE POLICIES AND PROCEDURES WE FOLLOW IN IMPLEMENTING OUR STATUTORY MANDATE. I WOULD BE PLEASED TO ANSWER ANY QUESTIONS YOU MAY HAVE.

# REGULATIONS GOVERNING SURETY COMPANIES DOING BUSINESS WITH THE UNITED STATES

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Department Circular No. 297
Revised September 1, 1978

DEPARTMENT OF THE TREASURY
Washington, D. C.
September 1, 1978

Fiscal Service
Bureau of Government Financial
Operations

Department Circular No. 297, revised March 20, 1978 (31 CFR, Part 223), is hereby revised to read as follows, effective September 1, 1978:

§ 223.1 Certificate of authority.

The regulations in this part will govern the issuance by the Secretary of the Treasury of certificates of authority to bonding companies to do business with the United States as sureties on, or reinsurers of, recognizances, stipulations, bonds, and undertakings, hereinafter sometimes called obligations, under the provisions of the Act of July 30, 1947 (61 Stat. 646, as amended: 6 U.S.C. 6-13), and the acceptance of such obligations from such companies so long as they continue to hold said certificates of authority.

§ 223.2 Application for certificate of authority.

Every company wishing to apply for a certificate of authority shall address the Assistant Comptroller for Auditing, Bureau of Government Financial Operations, U.S. Department of the Treasury, Washington, D. C. 20226, who will notify the company of the data which the Secretary of the Treasury determines from time to time to be necessary to make application. In accord with 6 U.S.C. 8 the data will include a copy of the applicant's charter or articles of incorporation and a statement, signed and sworn to by its president and secretary, showing its assets and liabilities. A fee shall be transmitted with the application in accordance with the provisions of § 223.22(a)(1).

§ 223.3 Issuance of certificates of authority.

(a) If, from the evidence submitted in the manner and form herein required subject to the guidelines referred to in § 223.9, the Secretary of the Treasury shall be satisfied that such company has authority under its charter or articles of incorporation to do the business provided for by the Act referred to in § 223.1, and if the Secretary of the Treasury shall be satisfied from such company's financial statement and from any further evidence or information he may require, and from such examination of the company, at its own expense, as he may cause to be made, that such company has a capital fully paid up in cash of not less than $250,000, is solvent and financially and otherwise qualified to do the business provided for in said Act, and is able to keep and perform its contracts, he will, subject to the further conditions herein contained, issue a certificate of authority to such company, under the seal of the Treasury Department, to qualify as surety on obligations permitted or required by the laws of the United States to be given with one or more sureties, for a term expiring on the last day of June next following. The certificate of authority shall be renewed annually on the first day of July, so long as the company remains qualified under the law and the regulations in this part, and transmits to the Assistant Comptroller for Auditing by March 1 each year the fee in accordance with the provisions of § 223.22(a)(3).

(b) If a company meets the requirements for a certificate of authority as an acceptable surety on Federal bonds in all respects except that it is a United States branch of a company not incorporated under the laws of the United States or of any State, or it is limited by its articles of incorporation or corporate charter to reinsurance business only, it may be issued a certificate of authority as a reinsuring company on Federal bonds. The fees for initial application and renewal of a certificate as a reinsuring company shall be the same as the fees for a certificate of authority as an acceptable surety on Federal bonds.

§ 223.4 Deposits.

No such company will be granted authority to do business under the provisions of the Act referred to in § 223.1 unless it shall have and maintain on deposit with the Insurance Commissioner, or other proper financial officer, of the State in which it is incorporated, or of any other State of the United States, for the protection of claimants, including all its policyholders in the United States, legal investments having a current market value of not less than $100,000.

§ 223.5 Business.

(a) The company must engage in the business of suretyship whether or not also making contracts in other classes of insurance, but shall not be engaged in any type or class of business not authorized by its charter or the laws of the State in which the company is incorporated. It must be the intention of the company to engage actively in the execution of surety bonds in favor of the United States.

(b) No bond is acceptable if it has been executed (signed and/or otherwise validated) by a company or its agent in a State where it has not obtained that State's license to do surety business. Although a company must be licensed in the State or other area in which it executes a bond, it need not be licensed in the State or other area in which the principal resides or where the contract is to be performed. The term "other area" includes the Canal Zone, District of Columbia, Guam, Puerto Rico, and the Virgin Islands.

§ 223.6 Requirements applicable to surety companies.

Every company now or hereafter authorized to do business under the Act of Congress referred to in § 223.1 shall be subject to the regulations contained in this part.

§ 223.7 Investment of capital and assets.

The cash capital and other funds of every such company must be safely invested in accordance with the laws of the State in which it is incorporated and will be valued on the basis set forth in § 223.9. The Secretary of the Treasury will periodically issue instructions for the guidance of companies with respect to investments and other matters. These guidelines may be updated from time to time to meet changing conditions in the industry.

§ 223.8 Financial reports.

(a) Every such company will be required to file with the Assistant Comptroller for Auditing, on or before the last day of January of each year, a statement of its financial condition made up as of the close of the preceding calendar year upon the annual statement blank adopted by the National Association of Insurance Commissioners, signed and sworn to by its president and secretary. On or before the last days of April, July and October of each year, every such company shall file a financial statement with the Assistant Comptroller for Auditing as of the last day of the preceding month. A form is prescribed by the Treasury for this purpose. The quarterly statement form of the National Association of Insurance Commissioners, when modified to conform to the Treasury's requirements, may be substituted for the Treasury's form. The quarterly statement will be signed and sworn to by the company's president and secretary or their authorized designees.

(b) Every such company shall furnish such other exhibits or information, and in such manner, as the Secretary of the Treasury may at any time require.

§ 223.9 Valuation of assets and liabilities.

In determining the financial condition of every such company, its assets and liabilities will be computed in accordance with the guidelines contained in the Treasury's current Annual Letter to Executive Heads of Surety Companies. However, the Secretary of the Treasury may value the assets and liabilities of such companies in his discretion. Credit will be allowed for reinsurance in all classes of risks if the reinsuring company holds a certificate of authority from the Secretary of the Treasury, or has been recognized as an admitted reinsurer in accord with § 223.12.

§ 223.10 Limitation of risk.

Except as provided in § 223.11, no company holding a certificate of authority shall underwrite any risk on any bond or policy on behalf of any individual, firm, association, or corporation whether or not the United States is interested as a party thereto, the amount of which is greater than 10 percent of the paid up capital and surplus of such company, as determined by the Secretary of the Treasury. That figure is hereinafter referred to as the underwriting limitation.

§ 223.11 Limitation of risk: Protective methods.

The limitation of risk prescribed in § 223.10 may be complied with by the following methods:

(a) Coinsurance. Two or more companies may underwrite a risk on any bond or policy, the amount of which does not exceed their aggregate underwriting limitations. Each company shall limit its liability upon the face of the bond or policy, to a definite specified amount which shall be within its underwriting limitation.

(b) Reinsurance.

(1) In respect to bonds running to the United States, liability in excess of the underwriting limitation shall be reinsured within 45 days from the date of execution and delivery of the bond with one or more companies holding a certificate of authority from the Secretary of the Treasury. Such reinsurance shall not be in excess of the underwriting limitation of the reinsuring company. Where reinsurance is contemplated, Federal agencies may accept a bond from the direct writing company in satisfaction of the total bond requirement even though it may exceed the direct writing company's underwriting limitation. Within the 45 day period, the direct writing company shall furnish to the Federal agency any necessary reinsurance agreements. However, a Federal agency may, at its discretion, require that reinsurance be obtained within a lesser period than 45 days, and may require completely executed reinsurance agreements in hand before making a final determination that any bond is acceptable. Reinsurance may protect bonds required to be furnished to the United States by the Miller Act (40 U.S.C. 270a - 270d) covering contracts for the construction, alteration, or repair of any public building or public work of the United States, as well as other types of Federal bonds. Use of reinsurance or coinsurance to protect such bonds is at the discretion of the direct writing company. Reinsurance shall be executed on reinsurance agreement forms (Standard Form 273 for Miller Act Performance bonds (formerly form No. TFS 6317), Standard Form 274 for Miller Act Payment bonds (formerly form No. TFS 6318), and Standard Form 275 for other types of Federal bonds (formerly form No. TFS 6319)). Federal bond-approving officers may obtain the forms by submitting a requisition in FEDSTRIP/MILSTRIP format to the General Services Administration regional office providing support to the requesting Government organization. In addition, the forms are available to authorized sureties and reinsurers from the Superintendent of Documents, Government Printing Office, Stop: SSMC, Washington, D.C. 20401.

(2) In respect to risks covered by bonds or policies not running to the United States, liability in excess of the underwriting limitation shall be reinsured within 45 days from the date of execution and delivery of the bond or policy with:

(i) One or more companies holding a certificate of authority from the Secretary of the Treasury as an acceptable surety on Federal bonds or one or more companies holding a certificate of authority as an acceptable reinsuring company on such bonds, or

(ii) One or more companies recognized as an admitted reinsurer in accord with § 223.12, or

(iii) A pool, association, etc., to the extent that it is composed of such companies, or

(iv) An instrumentality or agency of the United States which is permitted by Federal law or regulation to execute reinsurance contracts.

(3) No certificate-holding company may cede to a reinsuring company recognized under § 223.12 any risk in excess of 10 percent of the latter company's paid up capital and surplus.

(c) Other methods. In respect to all risks other than Miller Act performance and payment bonds running to the United States, which must be coinsured or reinsured in accord with § 223.11(a) or § 223.11(b)(1) respectively, the excess liability may otherwise be protected:

(1) By the deposit with the company in pledge, or by conveyance to it in trust for its protection, of assets admitted by the Treasury, the current market value of which is at least equal to the liability in excess of its underwriting limitation, or

(2) If such obligation was incurred on behalf of or on account of a fiduciary holding property in a trust capacity, by a joint control agreement which provides that the whole or a sufficient portion of the property so held may not be disposed of or pledged in any way without the consent of the insuring company.

§ 223.12 Recognition as reinsurer.

(a) Application by U. S. company. Any company organized under the laws of the United States or of any State thereof, wishing to apply for recognition as an admitted reinsurer (except on excess risks running to the United States) of surety companies doing business with the United States, shall file the following data with the Assistant Comptroller for Auditing and shall transmit therewith the fee in accordance with the provisions of § 223.22(a)(2).

(1) A certified copy of its charter or articles of incorporation, and

(2) A certified copy of a license from any State in which it has been authorized to do business, and

(3) A copy of the latest available report of its examination by a State Insurance Department, and

(4) A statement of its financial condition, as of the close of the preceding calendar year, on the annual statement form of the National Association of Insurance Commissioners, signed and sworn to by two qualified officers of the company, showing that it has a capital stock paid up in cash of not less than $250,000, in the case of a stock insurance company, or has net assets of not less than $500,000 over and above all liabilities, in the case of a mutual insurance company, and

(5) Such other evidence as the Secretary of the Treasury may determine necessary to establish that it is solvent and able to keep and perform its contracts.

(b) Application by a U. S. branch. A U. S. branch of an alien company applying for such recognition shall file the following data with the Assistant Comptroller for Auditing and shall transmit therewith the fee in accordance with the provisions of § 223.22(a)(2).

(1) The submissions listed in paragraphs (1) through (5) of paragraph (a) of this section, except that the financial statement of such branch shall show that it has net assets of not less than $250,000 over and above all liabilities, and

(2) Evidence satisfactory to the Secretary of the Treasury to establish that it has on deposit in the United States not less than $250,000 available to its policyholders and creditors in the United States.

(c) Financial reports. Each company recognized as an admitted reinsurer shall file with the Assistant Comptroller for Auditing on or before the first day of March of each year its financial statement and such additional evidence as the Secretary of the Treasury determines necessary to establish that the requirements of this section are being met. A fee shall be transmitted with the foregoing data, in accordance with the provisions of § 223.22(a)(4).

### § 223.13 Full penalty of the obligations regarded as the liability; exceptions.

In determining the limitation prescribed in this part, the full penalty of the obligation will be regarded as the liability, and no offset will be allowed on account of any estimate of risk which is less than such full penalty, except in the following cases:

(a) Appeal bonds; in which case the liability will be regarded as the amount of the judgment appealed from, plus 10 percent of said amount to cover interest and costs.

(b) Bonds of executors, administrators, trustees, guardians, and other fiduciaries, where the penalty of the bonds or other obligation is fixed in excess of the estimated value of the estate; in which cases the estimated value of the estate, upon which the penalty of the bond was fixed, will be regarded as the liability.

(c) Credit will also be allowed for indemnifying agreements executed by sole heirs or beneficiaries of an estate releasing the surety from liability.

(d) Contract bonds given in excess of the amount of the contract; in which cases the amount of the contract will be regarded as the liability.

(e) Bonds for banks or trust companies as principals, conditioned to repay moneys on deposit, where by any law or decree of a court the amount to be deposited shall be less than the penalty of the bond; in which cases the maximum amount on deposit at any one time will be regarded as the liability.

### § 223.14 Schedules of single risks.

During the months of January, April, July, and October of each year every company will be required to report to the Secretary of the Treasury every obligation which it has assumed during the three months immediately preceding, the penal sum of which is greater than 10 percent of its paid up capital and surplus, together with a full statement of the facts which tend to bring it within the provisions of this part, on a form suitable for the purpose.

§ 223.15 Paid up capital and surplus for Treasury rating purposes; how determined.

The amount of paid up capital and surplus of any such company shall be determined on an insurance accounting basis under the regulations in this part, from the company's financial statements and other information, or by such examination of the company at its own expense as the Secretary of the Treasury may deem necessary or proper.

§ 223.16 List of certificate-holding companies.

A list of qualified companies is published annually as of July 1 in Department Circular No. 570, Companies Holding Certificates of Authority as Acceptable Sureties on Federal Bonds and as Acceptable Reinsuring Companies, with information as to underwriting limitations, areas in which licensed to transact surety business, and other details. If the Secretary of the Treasury shall take any exceptions to the annual financial statement submitted by a company, he shall, before issuing Department Circular 570, give a company due notice of such exceptions. Copies of the Circular are available from the Assistant Comptroller for Auditing upon request. Selection of a particular qualified company from among all companies holding certificates of authority is discretionary with the principal required to furnish bond.

§ 223.17 Revocation.

Whenever it appears that a company is not complying with the requirements of 6 U.S.C. 6-13 and of the regulations in this part, the Secretary of the Treasury will (a) in all cases notify the company of the facts or conduct which indicate such failure, and provide opportunity to the company to respond, and (b) in those cases where the public interest in the constant financial stability of such company allows, also provide opportunity to the company to demonstrate or achieve compliance with those requirements. The Secretary shall revoke a company's certificate of authority with advice to it if (1) the company does not respond satisfactorily to his notification of noncompliance, or (2) the company, provided an opportunity to demonstrate or achieve compliance, fails to do so.

§ 223.18 Performance of agency obligations.

(a) Every company shall promptly honor its bonds naming the United States or one of its agencies or instrumentalities as obligee. If an agency's demand upon a company on behalf of the agency or laborers, materialmen or suppliers (on payment bonds), for payment of a claim against it is not settled to the agency's satisfaction, and the agency's review of the situation thereafter establishes that the default is clear and the company's refusal to pay is not based on adequate grounds, the agency may make a report to the Secretary of the Treasury, including a copy of the subject bond, the basis for the claim against the company, a chronological resume of efforts to obtain payment, a statement of all reasons offered for nonpayment, and a statement of the agency's views on the matter.

(b) On receipt of such report from the Federal agency, the Secretary will, if the circumstances warrant, notify the company concerned that the agency report may demonstrate that the company is not keeping and performing its contracts and that, in the absence of satisfactory explanation, the company's default may preclude the renewal of the company's certificate of authority, or warrant prompt revocation of the existing certificate. This notice will provide opportunity to the company to demonstrate its qualification for a continuance of the certificate of authority.

§ 223.19 Informal hearing on agency complaints.

(a) Request for informal hearing. If a company determines that the opportunity to make known its views, as provided for under § 223.18(b), is inadequate, it may, within 20 business days of the date of the notice required by § 223.18(b), request, in writing, that the Secretary of the Treasury convene an informal hearing.

(b) Purpose. As soon as possible after a written request for an informal hearing is received, the Secretary of the Treasury shall convene an informal hearing, at such time and place as he deems appropriate, for the purpose of determining whether revocation of the company's certificate of authority is justified.

(c) Notice. The company shall be advised, in writing, of the time and place of the informal hearing and shall be directed to bring all documents, records and other information as it may find necessary and relevant to substantiate its refusal to settle the claims made against it by the Federal agency making the report under § 223.18(a).

(d) Conduct of hearings. The hearing shall be conducted by a hearing officer appointed by the Secretary. The company may be represented by counsel and shall have a fair opportunity to present any relevant material and to examine the agency's evidence. Formal rules of evidence will not apply at the informal hearing.

(e) Report. Within 30 days after the informal hearing, the hearing officer shall make a written report to the Secretary setting forth his findings, the basis for his findings, and his recommendations. A copy of the report shall be sent to the company.

### § 223.20 Final decisions.

If, after review of the case file, it is the judgment of the Secretary that the complaint was unfounded, the Secretary shall dismiss the complaint by the Federal agency concerned and shall so notify the company. If, however, it is the judgment of the Secretary that the company has not fulfilled its obligations to the complainant agency, he shall notify the company of the facts or conduct which indicate such failure and allow the company 20 business days from the date of such notification to demonstrate or achieve compliance. If no showing of compliance is made within the period allowed, the Secretary shall either preclude renewal of a company's certificate of authority or revoke it without further notice.

### § 223.21 Reinstatement.

If, after one year from the date of the expiration or the revocation of the certificate of authority under § 223.20, a company can show that the basis for the non-renewal or revocation has been eliminated and that it can comply with the requirements of 6 U.S.C. 6-13 and the regulations in this part, a new certificate of authority shall be issued without prejudice.

### § 223.22 Fees for services of the Treasury Department.

(a) Fees shall be imposed and collected, for the services listed in subparagraphs (a)(1) - (a)(4) of this section which are performed by the Treasury Department, regardless of whether the action requested is granted or denied. The payee of the check or other instrument shall be the Bureau of Government Financial Operations, Treasury Department. The amount of the fee will be based on which of the following categories of service is requested:

(1) Examination of a company's application for a certificate of authority as an acceptable surety on Federal bonds or for a certificate of authority as an acceptable reinsuring company on such bonds (see § 223.2);

(2) Examination of a company's application for recognition as an admitted reinsurer (except on excess risks running to the United States) of surety companies doing business with the United States (see § 223.12(a) and (b));

(3) Determination of a company's continuing qualifications for annual renewal of its certificate of authority (see § 223.3); or

(4) Determination of a company's continuing qualifications for annual renewal of its authority as an admitted reinsurer (see § 223.12(c)).

(b) In a given year a uniform fee will be collected from every company requesting a particular category of service, e.g., determination of a company's continuing qualifications for annual renewal of its certificate of authority. However, the Treasury Department reserves the right to redetermine the amounts of fees annually. Fees are determined in accordance with Office of Management and Budget Circular A-25, as amended.

(c) Specific fee information may be obtained from the Assistant Comptroller for Auditing at the address shown in § 223.2. In addition, a notice of the amount of a fee referred to in § 223.22(a)(1)-(a)(4) will be published in the Federal Register as each change in such fee is made.

Superseded regulations. The foregoing regulations supersede all previous regulations relating to the same subject.

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Commissioner
Bureau of Government
Financial Operations

DEPARTMENT OF THE TREASURY
FISCAL SERVICE
BUREAU OF GOVERNMENT FINANCIAL OPERATIONS
WASHINGTON, D.C. 20226
Telephone (202) 634-5010

IN REPLYING QUOTE:
G-CA

December 31, 1981

ANNUAL LETTER TO EXECUTIVE HEADS OF
SURETY COMPANIES REPORTING TO THE TREASURY:

Under existing law and Treasury regulations, the 1981 annual financial statements of all companies holding Treasury certificates of authority must be filed with the Department not later than January 31, 1982.

Where it is impossible to file a complete annual financial statement within the time prescribed by law, a preliminary or provisional financial statement may be submitted on or before January 31, 1982, to comply with legal requirements. A preliminary statement in the form of a balance sheet, showing the company's assets and liabilities on a provisional basis, will suffice (no Treasury forms are stocked for this purpose). However, full returns must be made not later than March 1, 1982.

It is requested that the reports be made to the Treasury Department on the fire and casualty form, approved by the National Association of Insurance Commissioners (N.A.I.C.). Copies of these report forms should be obtained from insurance supervisory officials of the States under the laws of which the companies are incorporated and all schedules filled out in complete detail. These statements, as well as the preliminary statements mentioned above, should be signed manually (facsimile signatures are not acceptable) and sworn to by the company's President and Secretary and be signed and sealed by a notary. There are enclosed herewith blank schedules of "Excess Risks" which should be made a part of such reports. Reporting requirements to be observed by the companies are outlined in the enclosed instructions.

The attached instructions differ from previous years. Included are the following changes:

(1) Instruction VII has been revised to mention a specimen letter of credit. Letters of credit in this format should be used to offset reinsurance recoverable reported on Treasury Schedule F, Part 2. The Treasury will also consider letters of credit in this format to be admissible in protecting certain excess risks mentioned in Instruction VIII. The format of this letter of credit was approved by the National Association of Insurance Commissioners in June 1981 and by the Treasury in August 1981.

*Keep Freedom in Your Future With U.S. Savings Bonds*

(2) Instruction XIX has been revised to eliminate the requirement that stock companies report the surplus required by the domiciliary State.

Please note that under Treasury regulations a fee of $700 is now applicable for renewal of certificates of authority (see Section 223.3 of Treasury Circular 297 - 31 CFR Section 223.3).

The timely submission of the required data in support of the annual reports (e.g., financial statements and related supporting documents of subsidiary companies, real estate appraisal reports, etc.) is the responsibility of the reporting company. In the absence of adequate supporting data, deductions will be made from the company's reported policyholders' surplus in establishing the Treasury underwriting limitation.

The enclosed Questionnaire and Check List are provided to assist you in making a complete filing. It may be returned, if so desired, with your annual report. Please address the annual report to: Audit Staff (Surety), Bureau of Government Financial Operations, Department of the Treasury, Washington, D.C. 20226.

W. E. Douglas
W. E. Douglas
Commissioner

Enclosures

## Instructions Relating to the Submission of Annual Financial Statements of Surety Companies to the Treasury Department

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These instructions are for the general guidance of surety companies seeking or holding Treasury certificates of authority. The guidelines set forth below are used by the Treasury Department for valuing assets and determining underwriting limitations of certificated companies in accordance with sections 223.9 and 223.10 of Department Circular No. 297 (31 CFR Part 223).

### I. Assets - General Criteria for Admissibility:

For Treasury rating purposes, property-liability insurance companies generally are limited to investments in cash items, marketable securities, mortgage loans (within certain limits), realty and computers necessary for the conduct of the company's business and collateral loans (secured by admissible collateral). Normal account balances such as agents' balances are usually admissible if collectible within 90 days. Reinsurance recoverable, salvage, miscellaneous assets, etc., are admissible if properly supported and meet the criteria outlined in the following instructions. Each investment (other than securities of affiliates or subsidiaries which are valued in accordance with Instruction III, and U.S. Government securities) is limited to 10 percent of total admitted assets, net of the item under consideration. For sundry assets shown in the annual statement, only those items which are adequately supported both as to value and convertibility within 90 days shall be admissible for Treasury rating purposes. Goodwill and other intangibles are not admissible assets for Treasury rating purposes.

Specific assets which are admissible under insurance laws of a particular State will not necessarily be admissible under Treasury criteria, because it is necessary for the Treasury to uniformly apply its criteria for admissibility to companies operating under diverse State laws. For example, under the laws of some States companies are sometimes permitted to invest a portion of their assets (usually less than 10 percent) in investments which would not normally be admissible investments for a property-liability insurance company. The Treasury normally non-admits such investments.

No part of said cash capital, or of any other assets or funds of any such company shall be invested in or loaned on its own stock. No part of said cash capital, or of any other assets or funds shall be loaned unless such loan shall be secured by a mortgage on unencumbered, improved or productive real estate within the United States, such loan not to exceed 60 percent of the current market value of the mortgaged premises; or by the pledge of bonds or stocks or other evidences of indebtedness, such loan at no time to be in excess of 90 percent of the current market value of the securities pledged; or by pledge of bonds or other evidences of indebtedness of the United States, the market value of which is equal to at least the amount loaned thereon. No part of the capital of any such company shall be or remain invested in or loaned upon any security or real estate subject to any prior lien.

The general restrictions outlined in this instruction shall not apply to assets acquired as salvage if they are being liquidated with reasonable promptness.

II. Securities:

In the annual financial statement, securities owned by reporting companies should be valued on bases not to exceed the following:

(a) Amply secured bonds, if not in default as to the payment of principal or interest, should be based upon the principle of amortization. The amortized value, if the bonds were purchased at par, should represent the par value. If the bonds were purchased above or below par, the amortized value should represent the purchase price, adjusted so as to bring the value to par at maturity and so as to yield, in the meantime, the effective rate of interest at which the purchase was made.

(b) Bonds which are not amply secured, or on which there has been a default in the payment of principal or interest, should be based upon market quotations as of December 31, 1981.

(c) Stocks should be valued on the basis of market prices as of December 31, 1981, as shown in the valuations promulgated by the Committee on Valuation of Securities, N.A.I.C.

(d) Notes, certificates and other evidences of indebtedness should be based upon market quotations as of December 31, 1981.

(e) Securities of controlled or affiliated companies will be valued in accordance with Instruction III below.

The foregoing instructions with respect to bond value are confined to basic principles of amortization. Where companies are required by local insurance departments to use slightly different bond valuation procedures, which for practical purposes are substantially in accordance with Treasury Department requirements, the Treasury will not object to the filing of financial statements prepared on such bases, when the methods adopted are consistently followed from period to period.

Actual market quotations as listed in the Bank and Quotation Record or other publication containing market quotations as of December 31, 1981 should be used when the value of stocks, bonds or notes (except securities of controlled or affiliated companies) is not listed by the Committee on Valuation of Securities. Detailed information should be furnished to substantiate the valuation reported, including a specific reference to the date and page number of the publication in which the particular security is listed. In the case of stocks, when no sales are reported, the mean between the bid and the asked prices should be used. Where quotations are not available, the stocks should be valued in accordance with the best information available and advice furnished as to the basis used in arriving at the valuation. A security is normally non-admissible unless it is readily marketable (may be liquidated within 90 days), as evidenced by it being actively traded on an active, reliable and continuous market (such as would be achieved by trading on a national exchange or two or more regional exchanges).

## III. Securities of Controlled Companies:

Reporting companies owning securities of other insurance companies, which are under the same direction and control as the reporting companies, should furnish copies of the annual financial statements of such other companies. These statements should be submitted on the form approved by the N.A.I.C. for use as of December 31, 1981. The value of assets shown in the statements will be determined on the same basis as if held directly by the reporting company. Each statement should be signed manually and sworn to by the President and Secretary of the controlled company and be signed and sealed by a notary. Copies of the latest Reports of Examination of such companies should accompany the financial reports, provided that the Treasury has not previously been furnished such reports.

Reporting companies owning securities of companies other than insurance companies, which are under the same direction and control as the reporting companies, should furnish copies of the balance sheets of such companies as of the reporting date. These statements should be certified by an officer of the controlling company. The value of assets shown in the statements will be determined on the same basis as if held directly by the reporting company. Accordingly, the assets reported in such balance sheets should be supported in the same detail as required in the form prescribed by the N.A.I.C. for insurance companies. As an example, if the balance sheet shows mortgages owned, data supporting the value of such mortgages should be furnished in the same manner called for in Schedule B of the Convention Form, including appraisals as covered in Instruction IV below. The Treasury normally non-admits debt instruments of affiliated companies (except premium finance companies) because such instruments generally constitute a direct or indirect loan to a substantial stockholder (see Instruction V).

## IV. Real Estate and Mortgages - Appraisals Required:

Values shown for these items in the annual financial statement, will be considered in accordance with the following criteria:

(a) Real Estate - Only realty essential to the operating needs of the company for conducting its business is admissible (at cost less depreciation) for Treasury rating purposes.

The value of each parcel of real estate must be supported by an acceptable appraisal as defined in item (c) of this instruction. Realty held solely for investment is non-admissible for Treasury rating purposes. Improved or unimproved salvage realty is normally admissible (if supported by a competent appraisal) for a period of two years to permit its disposition. Land contracts are normally non-admissible.

(b) Mortgages - Conventional first mortgage loans on unencumbered, improved, or productive real estate located within the United States are admissible at 60 percent of the appraised value of the property, provided they are supported by a competent appraisal as defined in item (c) of this instruction, and are protected by adequate fire insurance. For this purpose "improved" property means land on which there has been substantial building. Thus, mortgage loans on undeveloped land, construction loans, and loans on properties not being used for purposes for which they were valued, are not admissible for Treasury rating purposes. Chattel mortgages and related instruments whether carried as mortgages, secured notes or collateral loans are also normally non-admissible for Treasury rating purposes.

Items reported as FHA and VA mortgages (including participation certificates) are admissible at 100 percent of the open principal balance shown for them.

(c) Appraisals - An appraisal report which includes the information and computations normally used in arriving at a competent appraisal value, based upon (1) the property's cost, (2) market value, and/or (3) income-producing capability, as applicable, must be furnished to support the value of each mortgage investment made and each new parcel of real estate acquired during the calendar year. If an appraisal is furnished covering land purchased, on which the company later constructs a company office building, it is not necessary to submit a subsequent appraisal covering construction costs of the building.

Appraisals need not be furnished covering direct mortgage loans or participation certificates in mortgages fully insured by the FHA, VA or other instrumentality of the United States. In such cases Schedule B of the annual financial statement should specify which Federal agency is insuring the loan.

V. Miscellaneous Assets:

Complete information must be furnished relative to any salvage or miscellaneous assets included in the balance sheet, and the value of such items must be satisfactorily supported. Otherwise, such items will not be allowed as admitted assets for rating purposes. Salvage, if satisfactorily supported, is normally admissible for a period of two years to permit its disposition. Salvage realty must be supported by a competent appraisal (see Instruction IV [c]). Direct or indirect loans to officers, directors, substantial stockholders (corporate or individual), or members of their families, whether secured or not, will not be considered as admitted assets for rating purposes. Loans secured by the company's own stock are also non-admissible. Collateral loans are admitted at full value if secured by U.S. Government securities having an equal market value, or admitted at 90 percent of their face value if fully secured by other admissible collateral.

## VI. Minimum Reserve Requirements:

Companies transacting surety business should carry a minimum reserve for incurred but not reported losses on such business as shown in the following table. Additional reserves should be provided where the minimum reserve is considered to be inadequate.

| Number of Years Company Has Written Surety Business | Minimum Rates Percent of Surety Premiums in Force |
|---|---|
| 3 or less | 1-3/4% |
| 4 through 6 | 2-5/8% |
| 7 or more | 3-1/2% |

Companies transacting surety bail business should establish a minimum reserve (utilizing company funds) for unearned premiums sufficient to reinsure such business in the event of insolvency. This reserve should equal the lesser of 35 percent of bail premiums in force or $7 per $1,000 of bail liability. Bail premiums in force are those relating to the December 31 outstanding bail liability whether or not the premiums are recorded as earned when the bond is written, but are not intended to include bail agents' fees. A schedule showing bail premiums in force or bail liability and the associated unearned premium reserve should be attached to the annual statement.

## VII. Reinsurance:

There is enclosed a revised Schedule F (Form No. TFS 6314) listing the companies, pools and associations which are recognized by the Treasury. It is requested that the information reflected in Schedule F of the company's annual statement be reported on the Treasury form in accordance with instructions shown on the latter schedule. Please forward the completed schedule (original only) to the Treasury Department with the company's annual statement. There are also enclosed separate lists showing (1) companies authorized to execute and reinsure bonds in favor of the United States, and (2) companies, pools and associations recognized by the Treasury as admitted reinsurers (except on excess risks running to the United States) of surety companies doing business with the United States. When reserves are not provided for reinsurance ceded to unauthorized companies, the company's surplus will be adjusted for Treasury rating purposes to provide such reserves.

Companies reporting funds held under reinsurance treaties may receive credit for unauthorized reinsurance to the extent of funds withheld from unauthorized companies, provided that the Treasury is advised as to the amount held for each company. This may be accomplished by including necessary information relative to the unauthorized reinsurance in Treasury Schedule F, Part 2.

Letters of credit issued to surety companies and reported in Schedule F, Part 2 of a company's financial statement may be recognized as an offset to reinsurance recoverable on paid and unpaid losses and unearned premiums for reinsurance ceded to companies not recognized by the Treasury for reinsurance purposes. Such letters of credit should be for a period of not less than one year and must be clean, irrevocable, unconditional letters of credit issued by a national bank or a member bank of the Federal Reserve System. The unused balance of each letter of credit should be entered as a separate item in Schedule F, Part 2, Column 4 of the company's financial statement and clearly identified by the pertinent number of the letter of credit and contract involved. Such balance should not be commingled on Schedule F, Part 2 with other letters of credit or other deposits which the company may report. A specimen letter of credit is attached.

## VIII. Excess Risks:

Treasury regulations provide that no company authorized to do business with the United States may expose itself on a single risk in an amount exceeding 10 percent of its combined capital and surplus, as established by the Treasury, unless the excess liability is protected by one of the several means authorized in 31 CFR Part 223.11 (Treasury Circular 297). Each company should report quarterly to the Treasury every risk which it has underwritten, either directly or through assumed reinsurance, during the preceding three months in excess of its Treasury underwriting limitation. These requirements are not limited to surety risks but apply to all bonds or policies in all lines of business (e.g. fire, marine, public liability, etc.), whether or not the United States is a party to the risk.

Quarterly reports of such excess risks should be made on Treasury Form TFS 285-A, Schedule of Excess Risks. When an excess risk running to the United States is reinsured, the reinsurance agreement should be executed on a reinsurance agreement form and filed in accordance with the instructions given on the form. Use Standard Form 273 for Miller Act performance bonds, Standard Form 274 for Miller Act payment bonds and

Standard Form 275 for all other Federal bonds. The previous forms, No. TFS 6317, TFS 6318, and TFS 6319, may continue to be used.

## IX. Capital Changes:

Where there have been changes in paid-up capital and/or contributions to surplus, there should be forwarded, if available, certificates by the insurance supervisory authorities of the company's State of incorporation, certifying to the verification of such transactions.

## X. Changes in Stock Ownership:

The Treasury requires each stock surety company to furnish a list of stockholders in support of its application. So that this Department may be currently informed regarding the ownership of capital stock, it is requested that each such company submit a statement signed and sworn to by the Secretary or Assistant Secretary and by the Treasurer or Assistant Treasurer of the reporting company, each time in the future any person becomes owner of more than 5 percent of any class of outstanding stock issued by the company, within 10 days after his becoming such owner of record. Any such changes which have occurred subsequent to the submission of the original list and which have not been reported to date, should be forwarded with your annual financial statement.

Also, whenever the record of ownership of a stockholder increases or decreases by 5 percent or more of any class of outstanding capital stock issued by the company, either in one transaction or in a series of transactions from time to time, the company should file such changes within 10 days from the date as of which such changes aggregate 5 percent or more.

For purposes of these instructions "person" is not limited to natural persons, but also includes corporations, partnerships, pension funds, profit sharing funds, and any organization of whatever nature.

## XI. Mergers, Transfers and Assumptions, Etc.:

The Treasury should be promptly advised regarding proposed or effected mergers, consolidations, transfers and assumptions, name changes, etc., in which the reporting company is involved. Copies of agreements or documents pertaining thereto, as approved by the Insurance Department of the company's domiciliary State, should be furnished so that the Treasury may take timely action and advise Federal bond-approving officers accordingly, where necessary.

## XII. Charter Amendments:

In the event that the charter of a company has been amended during the period, there should be forwarded a certified copy of such amendment or amended charter unless these papers have been previously filed with the Treasury.

### XIII. Explanatory Memoranda — Loss Reserves, Etc.:

In the event that a company has taken significant action in any area of operation which would not be evident from a review of the company's financial statements, such action should be explained fully in a supporting memorandum. For example, if during 1981 the company has increased loss reserves to compensate for inadequate prior years' reserves, the circumstances and amounts involved should be explained (including specific advice as to the extent the incurred losses shown in Schedules O and P were adjusted, on the basis of a review of unpaid losses as contrasted with the payment of losses). Should the Treasury's review reveal that reserves for losses incurred in prior years were substantially inadequate in light of subsequent developments as shown by Schedules O, P, or G of its annual statement or by other information available, the company's reported surplus will be adjusted accordingly (unless the company furnishes confirmation satisfactory to the Treasury, from a C.P.A. firm, independent actuary or State insurance department, that its reserves are adequate at December 31, 1981). Accordingly, companies filing annual statements which show serious adverse reserve development on Schedules O, P, or G may wish to make plans to obtain such confirmation.

Other actions which might require explanatory memoranda would be the discontinuance of unprofitable lines, special reinsurance arrangements, and items of a similar nature.

### XIV. Premium Volume:

Inasmuch as excessive premium volume increases the vulnerability of a company to large underwriting losses, net premium volume should be kept at a justifiable level in relation to policyholders' surplus. The Treasury may request justification if the net premiums written to policyholders' surplus ratio exceeds 2:1 when accompanied by successive years of net underwriting losses.

### XV. State Examination Reports:

If a company has been examined during the year by a State insurance department, a copy of the examination report, if available, should be forwarded with the annual financial statement (provided that the Treasury has not already been furnished a copy). In the future, copies of such reports should be furnished the Treasury within 10 days after receipt by each reporting company.

### XVI. C.P.A. Reports:

If a company has been audited during the year by a C.P.A. firm, or if a company is a member of a group which has been audited, a copy of the audit report, if available, should be forwarded with the annual statement. This would include audit reports included in annual reports to stockholders and S.E.C. 10-K reports. If a C.P.A. report is not included with the annual financial statement, a note should be attached to page 15 of the annual statement indicating the reason an auditors' report is not included. Please give an estimated filing date if one will be filed after the March 1, annual filing deadline.

XVII. Contingent Liabilities:

Contingent liabilities are normally deducted from policyholders' surplus for Treasury rating purposes.

XVIII. Claims - Prompt Payment:

The Treasury expects companies to honor valid Federal claims promptly (see 31 CFR 223.18-20). In addition, 6 U.S.C. 11 provides that a final judgment on a Federal claim (from which no appeal or supersedeas has been taken) must be satisfied within 30 days. Failure to do so may result in termination of a company's certificate of authority.

XIX. Surplus in Excess of Capital:

In order for a company to continue as an acceptable surety on Federal bonds, it must maintain sufficient surplus in excess of capital to preclude the possibility of capital impairment for Treasury rating purposes. Beginning with the year 1977, the Treasury established a minimum surplus in excess of capital requirement which now equals 100 percent of capital. This requirement was phased in over a five-year period in increments of 20 percent per year. For the year ending December 31, 1981, the Treasury normally will consider surplus in excess of capital to be insufficient unless surplus, after adjustment for Treasury rating purposes, equals 100 percent of capital.

For mutual companies and United States branches, the legally required surplus or guaranty fund which equates to capital under the laws of the company's domiciliary state will be equated to capital for Treasury rating purposes. Therefore, mutual companies and United States branches should supply information to show the legally required surplus or guaranty fund.

W.E.

W. E. Douglas
Commissioner, Bureau of
Government Financial Operations

Date: December 31, 1981

ATTACHMENT
Approved August, 1981

DEPARTMENT OF THE TREASURY
FISCAL SERVICE
BUREAU OF GOVERNMENT FINANCIAL OPERATIONS
WASHINGTON, D.C. 20226

IN REPLYING QUOTE
G-CA

FORMAT OF LETTER OF CREDIT TO BE USED BY SURETY COMPANIES DOING BUSINESS WITH THE UNITED STATES. In order to be admissible for financial statement or excess risks purposes any letter of credit shall be in the format given below.

(References 31 CFR 223.9 and 223.11 (c)(1); Treasury current Annual Letter to Executive Heads of Surety Companies Reporting to the Treasury, Instructions VII and VIII)

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Letterhead of national bank or member bank of Federal Reserve System

NAME OF BENEFICIARY

REF: IRREVOCABLE CLEAN LETTER OF CREDIT NO.

GENTLEMEN:

AT THE REQUEST OF ______________________________

WE HAVE ESTABLISHED OUR CLEAN IRREVOCABLE CREDIT NO.

IN YOUR FAVOR AS STATED BELOW:

AMOUNT:

EXPIRING ON:

IF WE RECEIVE HERE AT OUR OFFICE ON OR BEFORE THE EXPIRY HEREOF, YOUR SIGHT DRAFT ON US, MENTIONING OUR REFERENCE NUMBER, FOR ALL OR PART OF THIS CREDIT, WE WILL PROMPTLY HONOR THE DRAFT. IT IS A CONDITION OF THIS LETTER OF CREDIT THAT IT WILL BE AUTOMATICALLY EXTENDED FOR PERIODS OF ONE YEAR FROM THE THEN RELEVANT EXPIRY DATE UNLESS THIRTY (30) DAYS PRIOR TO THAT RELEVANT EXPIRY DATE THE ISSUER BY WRITTEN NOTICE TO THE BENEFICIARY ELECTS NOT TO EXTEND THIS LETTER OF CREDIT. EXCEPT AS STATED HEREIN, THIS UNDERTAKING IS NOT SUBJECT TO ANY CONDITIONS OR QUALIFICATION WHAT-SO-EVER. SHOULD YOU HAVE ANY OCCASION TO COMMUNICATE WITH US REGARDING THIS CREDIT, KINDLY DIRECT YOUR COMMUNICATIONS TO THE ATTENTION OF ____________________

VERY TRULY YOURS,

TEL:

*Keep Freedom in Your Future With U.S. Savings Bonds*

COMMISSIONER

DEPARTMENT OF THE TREASURY
FISCAL SERVICE
BUREAU OF GOVERNMENT FINANCIAL OPERATIONS
WASHINGTON, D.C. 20226

April 12, 1982

Dear Mr. Chairman:

I am writing in response to your letter of March 29, 1982 requesting a chronology of Bureau-initiated actions regarding Treasury licensing procedures for sureties. Attachment I details actions concerning International Fidelity Insurance Company and Attachment II details actions concerning American Fidelity Fire Insurance Company.

The Bureau has discussed with Department legal officials the extent of its authority under Title 6 U.S. Code. We will request an additional review of the Bureau's analysis of that authority by high level Department legal officials that were not involved in the previous examination. We intend to ask that the additional review consider whether a determination to revoke or not renew a company's certificate of authority may be based on any of the following factors:

1. criminal conduct by, or connections of, individuals involved in the ownership or management of the company;

2. the company's record of losses initially sustained although later reimbursed to the company under a Federal guarantee program; and

3. whether a company's insufficient policing of claims submitted to SBA for payment under a guarantee constitutes a breach of the company's obligations to SBA under the guarantee contract and, if so, whether that breach or default is actionable under Title 6 U.S. Code.

In addition, on March 19, 1982, the Bureau requested the Treasury Inspector General to conduct a full scale review of the Bureau's current certification procedures and guidelines. We asked that the review include an evaluation of the financial standards established and a review of techniques used in our examinations.

Concurrently, the Bureau is seeking ways of improving communications with the State insurance departments and the National Association of Insurance Commissioners. We are also reviewing our licensing procedures and guidelines to determine whether or not there are areas within our statutory authority that should be given a stricter interpretation. We are considering additional requirements to be included in the annual reports which surety companies must file with the Bureau. For example, one such requirement would mandate that companies inform the Treasury of any restrictions imposed on the companies by State insurance departments.

*Keep Freedom in Your Future With U.S. Savings Bonds*

I trust that the foregoing list of actions taken or in progress responds to your request. If you have any further questions, please let me know.

Sincerely,

W.E. Douglas

W. E. Douglas

The Honorable
Lowell Weicker, Jr.
Chairman
Committee on Small Business
United States Senate
Washington, D.C. 20510

Attachments

Attachment I

## CHRONOLOGY OF ACTIONS RE: INTERNATIONAL FIDELITY INSURANCE COMPANY (IFIC)

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| September 25, 1980 | Letter from Senator Lowell Weicker, Jr. requesting (1) the termination of IFIC's Treasury certificate of authority due to criminal control and (2) a full-scale investigation of effectiveness of Treasury's guidelines and procedures for certifying companies. |
| September 1980 | The Legal Counsel (BGFO) contacted the Chief, Organized Crime and Racketeering Section, Department of Justice for the purpose of determining whether there was statutory authority to debar a company from dealings with Federal agencies based on criminal activity or criminal associations of individuals involved in the company's ownership or management. The Legal Counsel was advised that there was no such statutory authority of which the Chief of the Section was aware. This was later confirmed by the Office of Legal Counsel's research. |
| October 6, 1980 | Meeting was held between representatives of Treasury and SBA. |

Treasury (Bureau of Government Financial Operations):

Mr. Kenneth Schmalzbach, Legal Counsel
Mr. Joseph Ruffley, Director, Audit Staff
Mr. Guy Kelly, Technical Assistant, Audit Staff

Small Business Administration:

Mr. Paul Boucher, Inspector General
Mr. Raymond Reusche, Assistant IG for Investigations
Mr. Terry Crisp, Investigator

Subject: (1) What action could Treasury take against a company owned or managed by criminals, and (2) what action could Treasury take if SBA showed IFIC had written bonds well in excess of its underwriting authority?

Discussion: (1) Mr. Kelly and Mr. Schmalzbach pointed out that there is no law preventing a criminal from owning stock in a company doing business with the Government. Mr. Kelly also indicated that some of these companies are traded on the stock exchanges and may have as many as 20,000 shareholders. Checking on shareholders on a routine basis would be an immense task. In addition, Treasury's statutory criteria does not permit revocation based solely on the criminal activity of those involved in a company's ownership or management.

(2) Treasury indicated that IFIC's authority could be revoked for violating Treasury underwriting risk and reinsurance requirements, once it was proven. Outcome of meeting: Mr. Crisp requested copies of IFIC's quarterly reports on bonds written. He planned to use the reports to determine if IFIC had neglected to properly report and reinsure any bonds written in excess of the company's limit.

October 7, 1980 Mr. Kelly provided Mr. Crisp the quarterly reports for the current year, copies of the 1980 and 1979 Circular 570, a copy of the Treasury Circular 297 and a list of the officers and directors of Allegheny Mutual Casualty Company of Meadville, Pennsylvania (IFIC's principal reinsurer).

October 7, 1980 Treasury's Acting General Counsel reviewed the extent of Treasury's authority under Title 6 U.S. Code to take the action requested by Senator Weicker. The Acting General Counsel accepted the Bureau's view of the extent of Treasury's authority to address Senator Weicker's concerns. However, he suggested that, if the evidence underlying the allegations made before the Select Committee was referred to the Attorney General, it might lead to prosecutions that could produce circumstances under which a company's certificate of authority could be revoked consistent with Treasury's existing authority.

October 15, 1980 Mr. Schmalzbach and Mr. Kelly met with Mr. R. Michael Haynes, Minority Counsel for Senate Select Committee on Small Business. Mr. Haynes requested information as to Treasury's procedures used to qualify surety companies. Mr. Schmalzbach gave an overview of Treasury's law (6 USC 6-13) and indicated the two key elements were (1) solvency of the surety, and (2) ability to keep and perform its contracts. Mr. Haynes and Mr. Schmalzbach discussed whether Treasury could get into the matter of criminal

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| | ownership. Mr. Kelly then presented an over-view of how Treasury reviews the surety companies' financial statements. After further discussions of legal issues involved and considering the complexity of determining ownership of companies with a sufficient degree to take action, it was generally agreed that it was perhaps better to accept the Treasury's operation as what it was intended to be, a review for solvency and authority to do surety business. Mr. Haynes then requested information of the Audit Staff's staffing levels, types of work performed, and a sample application package. |
| October 16, 1980 | Mr. Kelly met with Mr. Fred Burkert, an internal auditor from the Small Business Administration. Mr. Burkert was planning to perform an audit of the SBA surety bond guarantee program and wanted information concerning methods of calculating surety losses incurred but not reported. Discussions were held concerning SBA program in general. Mr. Kelly recommended a course of action to help control losses through the reduction of the percentage guaranteed on companies showing the worst loss ratios. |
| October 17, 1980 | Mr. Kelly wrote Mr. Haynes providing the information requested at the October 15 meeting. |
| October 23, 1980 | Mr. Kelly contacted Mr. Crisp concerning problems retrieving IFIC's prior years excess risks schedules from Records Center. NOTE: All reports for the period 1/1/77 through 9/3/80 were found and sent to Mr. Crisp on November 14, 1980. |
| October 29, 1980 | Reply sent to Senator Weicker's letter by Commissioner Douglas. |
| December 8, 1980 | Mr. Kelly called Mr. Crisp to see what had developed on IFIC's excess risks. Mr. Crisp indicated he had not found a pattern of excess risk violations by IFIC; therefore, no action could be taken against IFIC. |
| February 24, 1981 | Mr. Kelly met with Mr. Richard McKay, Trial Attorney, Commercial Litigation Division, U.S. Dept. of Justice and Ms. Stephanie Richmond, Attorney, SBA Office of General Counsel, Litigation Office. Mr. McKay indicated he was engaged in discovery proceedings concerning an SBA lawsuit against IFIC which would result in IFIC paying some $600,000 if SBA won. Mr. McKay wanted to |

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| | know what financial impact such a judgment would have on IFIC's financial condition. Mr. Kelly indicated that while such a payment would be a financial blow to IFIC, it would not put IFIC out of business nor impair the company's surplus in excess of capital. Mr. Kelly provided Mr. McKay and Ms. Richmond with a copy of the company's balance sheet as published in Best's Insurance Reports - Property and Casualty. |
| February 26, 1981 | Treasury auditor called Ms. Richmond to inquire about results of proceedings against IFIC. Auditor found that IFIC and SBA had negotiated a out-of-court settlement of $100,000. |

There were no further questions or contacts concerning IFIC from SBA after this point.

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| May 1981 | Thorough financial review was completed on IFIC. There were no financial problems that warranted or permitted termination of company's authority. Company's authority was renewed for July 1 through June 30. We requested copy of State Examination report being made as of November 26, 1980. |
| June 1981 | IFIC responded that State Examination Report was not yet received; IFIC would send it as soon as received. |
| March 22, 1982 | Letter sent to IFIC again requesting copy of 1980 Report of Examination. Renewal of company's authority as of July 1 will be contingent on any adverse State findings and on company's financial condition at December 31, 1981. |
| March 30, 1982 | IFIC responded that the New Jersey Dept. of Insurance had performed a special review of the company on or about November 26, 1980; however, the New Jersey Insurance Dept. had not yet released the report. IFIC provided the name of the New Jersey examiner for us to contact and has forwarded a copy of our March 22 request to the New Jersey Insurance Department. |

Attachment II

## CHRONOLOGY OF ACTIONS RE:
## AMERICAN FIDELITY FIRE INSURANCE COMPANY (AFF)

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| March 29, 1980 | Mrs. Smolenyak, Audit Manager, sent to SBA a request for confirmation of "Accounts Receivable from SBA" shown on AFF's December 31, 1979 statement. Confirmation was addressed to Mr. Earl Chambers, Director, Office of Special Guarantees. |
| April 9, 1980 | Mr. Chambers responded to Mrs. Smolenyak stating that SBA was unable to verify balances of a surety for any given date. Mr. Chambers explained SBA's procedures and reasons why such a request could not be confirmed. Mr. Chambers suggested that SBA could give Treasury copies of the pay-out list for AFF compiled for January, February, March and April. Totals of these lists should come out close to figures shown on AFF's financial statement. |
| April 14, 1980 | Duplicate of March 29, 1980 request sent to Mr. James Davit, Director of Regulatory Audits, SBA. Mr. Kelly sent duplicate request to Mr. Davit due to Mr. Chambers being temporarily detailed to another office. Mr. Kelly expressed concern about the subject balances and their substantial impact on AFF's solvency. |
| May 13, 1980 | Mr. Spargo (SBA Auditor) called Ms. Smolenyak and informed her that SBA was unable to confirm AFF's balances due to the claims being handled through a third party. |
| May 13, 1980 | Mr. Dennis Lund (SBA Auditor) called Mr. Kelly concerning the request for confirmation. He indicated SBA had no real means of verifying the balances. Mr. Lund indicated the New York Insurance Department was examining AFF and had so far found that $1,000,000 of the receivables as of Dec. 31, 1978 could not be verified precisely due to the way AFF's billing system worked and SBA's accounting system worked.<br>Mr. Lund indicated that the accounting system was such that it appeared that AFF's accounts receivable were correct but that they could not confirm the balance by May 31 as we had requested.<br>Mr. Kelly indicated that as long as SBA was confident that the billing system was all right, we would accept the SBA receivable shown on AFF's statement. |

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| | Mr. Kelly and Mr. Lund also discussed AFF's improving financial condition. Mr. Lund asked for confirmation that we would renew AFF as of July 1980. |
| May 29, 1980 | Mr. Raymond F. Randolph, Assistant Inspector General for Audits, SBA wrote Mr. Kelly and confirmed AFF's receivable from SBA as of December 31, 1978. He stated that SBA could not confirm the balance as of December 31, 1979 due to the claims being handled through the third party. |
| June 2, 1980 | Mr. Kelly sent a letter to Mr. Lund acknowledging the telephone conversation of May 13 and confirmed that AFF's certificate of authority would be renewed. |
| November 24, 1980 | Mr. Kelly wrote to Mr. Edward Germann, Chief, Surveillance and Analysis Division, Insurance Department, State of California. Mr. Kelly requested Mr. Germann to provide any information he could concerning California's investigation of Market Insurance Corporation (the marketing agent for AFF). |
| December 9, 1980 | Mr. Raymond Randolph, Assistant Inspector General for Audits, SBA wrote Mr. Kelly and enclosed a copy of SBA's audit report entitled "Report on Compliance Audit of American Fidelity Fire Insurance Company." |
| December 24, 1980 | Mr. Germann replied to Mr. Kelly's letter and sent certain documents concerning Market Insurance Corporation. |
| January 5, 1981 | Mr. Kelly acknowledged Mr. Germann's letter and documents of December 24, 1980. |
| March 4, 1981 | Based on SBA's audit report, Mrs. Smolenyak, Audit Manager, wrote AFF. Mrs. Smolenyak informed AFF that in view of the problems SBA was having in confirming balances with AFF, the Treasury was requiring a confirmation from AFF's C.P.A. firm or the New York Insurance Department that the "Receivable from SBA" balances were accurate. In the absence of satisfactory confirmation, Treasury would not allow the receivable balance when determining whether the company's certificate would be renewed. |
| May 1981 | AFF's C.P.A. firm submitted a report on AFF's financial statement. The C.P.A. report, among other deductions, reduced the receivables shown on AFF's statutory financial statement. |

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| May 13, 1981 | AFF's certificate of authority was renewed effective July 1. New underwriting limitation as of July 1 reflected the adjustments made by the C.P.A. firm. |
| May 22, 1981 | Mr. Kelly wrote Mr. Davit, Director, Office of Regulatory Audits, SBA and informed him of the C.P.A. report results on AFF. Mr. Kelly informed Mr. Davit that Treasury required the C.P.A. certification based on SBA's audit report. |
| December 1981 | Mr. Germann of California Insurance Department sent Mr. Kelly a carbon copy of a letter sent Mr. Davit and also enclosed a copy of a California court decision barring the principals of Market Insurance Corporation from operating within the State of California. |
| December 23, 1981 | Mr. Kelly acknowledged receipt of Mr. Germann's letter and documents. |
| December 23, 1981 | Acting Director, Audit Staff wrote the Chief, Property Liability Bureau, New York Insurance Department. We informed New York of the action the California Insurance Department had taken against Market Insurance Corporation. We requested that New York examine the evidence and consider separating a New York domiciled insurer (AFF) from a business relationship with such principals. |
| December 23, 1981 | Acting Director, Audit Staff wrote Mr. Luther Williams, President, American Fidelity Fire. We informed him of the action the California Insurance Department had taken against Market Insurance Corporation. We requested AFF to re-evaluate the wisdom of its association with Market. |
| December 29, 1981 | Mr. Williams, President of AFF, wrote Mrs. Smolenyak and informed her that by letter dated October 19, 1981, AFF had, effective 90 days from that date, terminated its agency agreement with Market Insurance Corporation. |
| January 22, 1982 | New York Insurance Department acknowledged Treasury's December 23, 1981 letter. The Department is processing the letter. |
| January 22, 1982 | Mr. Kelly and Mrs. Mary Casey, BGFO Auditor met with Messrs. Marc Snolonsky and John McLean, Investigators, Senate Select Committee on Small Business. Discussions were held on (1) AFF's dealings with SBA and (2) problems in the SBA program itself. |

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| February 9, 1982 | Mrs. Casey received a call from an SBA auditor who stated that AFF apparently was not licensed in four states that the Treasury's Circular 570 showed the company as being licensed in. |
| February 10, 1982 | Letters were sent by an Audit Manager to the States of Georgia, Massachusetts, Connecticut and Illinois requesting information on any problems or restrictions re: AFF's license to transact surety business. |
| February 17, 1982 | Illinois Department of Insurance informed us that AFF is presently licensed in Illinois and can underwrite insurance business. AFF's license was suspended on June 30, 1978 but was reinstated on August 3, 1978 when company agreed to prohibition from accepting business generated in Illinois. Order prohibiting business expired June 30, 1979 and was not renewed. |
| February 18, 1982 | Georgia Department of Insurance responded that AFF's certificate of authority had never been revoked or suspended; however, on September 1976 at the Commissioner's request, AFF voluntarily ceased and desisted writing new and renewal business. During period of April 1977 through June 30, 1978, AFF was authorized to underwrite SBA bonds only under limited authority due to the market needs within the State. AFF has currently requested permission to resume unrestricted operations; however, Georgia does not anticipate an early decision on the request. |
| February 19, 1982 | Massachusetts Department of Insurance informed us that AFF's license had not been revoked but that the company was under restrictions as of September 6, 1978. On that date, AFF could no longer write new or renewal business; existing business would be allowed to run to expiration; and AFF could not assume reinsurance on any risk in Massachusetts. AFF's license was subject to surrender if AFF's capital and surplus fell below $2 million. This event did not occur. |
| March 15, 1982 | Connecticut Department of Insurance responded that AFF's license was limited to servicing of existing business as of November 1976. AFF cannot write new or renewal business. |
| April 1982 | Audit Staff is currently reviewing the replies from the State Insurance Departments; the Report on Examination of AFF as of December 31, 1978 by the New York Insurance Department (received 4/1/82); and the company's statutory financial statement as of December 31, 1981. We are preparing correspondence to the company requesting full information on (1) all restrictions on state licenses; (2) AFF's actions in response to New York's examination report; and (3) how AFF is currently handling its underwriting business after terminating its contract with Market. We are also requesting information on how the termination of AFF's contract with Market is going to affect AFF's financial condition. |

The **Chairman**. The next witness is Mr. Mountie Bedford of M. B. Underwriters, Pensacola, Fla.

Mr. Bedford, we will accept your statement in its entirety in the record at this point.

I'm a little bit concerned—and I have to say this to the remaining witnesses also—that we're going to be called to the floor in the Williams matter, and if that happens, I'm going to have to go ahead and recess these hearings. But I don't want to cause any more inconvenience than has already been caused to all of our witnesses.

So, if you would, we would appreciate it if you could possibly synopsize the main features, of your statement, and we will place it in its entirety into the record at this time. I know that we have questions to ask you, and I want to make sure we have a chance to get to them.

## STATEMENT OF MOUNTIE M. BEDFORD, PRESIDENT, M B UNDERWRITERS, PENSACOLA, FLA.

Mr. **Bedford**. Well, Mr. Chairman, I appreciate the opportunity to be here today.

Fortunately, I have very broad shoulders, so I think probably that I'll deviate from the prepared statement and discuss some things that have come to mind with some of the other witnesses.

I do represent Balboa Insurance Co., which is the largest single writer of bonds in the program. I also represented Morrison Assurance Co., a very fine company that was in the program for five 5 and withdrew this past December. The reason they withdrew—it was an administrative decision—they felt that having the amount of dollars tied up with the Federal Government in this program and not being able to get it returned to them on a timely basis when they had submitted those proper claims created cash flow problems for them. I think the other main concern was the inconsistencies from region to region in interpretation and application of SBA regulations and policy amendments.

It so happens that the Morrison Co. personnel were very much involved in this program, and as a result, they, like myself, became totally frustrated at times in trying to deal with the program.

I would like to say that we've heard about the standard markets/sureties—for 10 years, we've heard about the standard markets. I don't know that they're here today. I wonder where they are when the small contractor needs help. If the program would assist the standard markets to write a large insurance account, I assure you they would use the program.

I think that one of the problems that we have—Senator Rudman was inquiring about getting the larger companies in—I think they have problems with their large contractors. I don't see how they're going to allow a USF&G or an Aetna to get involved to assist a small contractor to become a larger contractor and compete.

I think there is a certain amount of prostitution of the program by those standard markets. Again, they use the program if it will help them write an insurance account, and the specialty companies involved in this program very seldom are involved in writing the insurance accounts.

I would also like to answer one other thing that the Inspector General pointed out. The specialty companies that they're referring to, the fact that it's such a large part of their program—Morrison Assurance Co. writes $25 million in business, and the SBG program accounts for maybe $1 million of it. Balboa writes in excess of $100 million, and I imagine that their writings in the SBG program are $5 million to $7 million. American Druggist writes $30 million, and I would imagine that the SBG program accounts for $2 million of it.

The standards pay lip service. I don't think—yes?

The **Chairman**. So what you're saying—excuse me for interrupting.

Mr. **Bedford**. Yes.

The **Chairman**. These are all good companies?

Mr. **Bedford**. Well, these are. Probably these three or four companies make up probably certainly the largest writer in the program at this time, that's true.

I did want to say something about that, because there may be a few companies where the SBG business is such a large amount of it, but I just felt that I needed to make that point.

The **Chairman**. But the point that I'm trying to make is that these are companies with which the Government's experience has been good. They're known as top-flight companies and yet they only really take a small part of this business.

Mr. **Bedford**. Of their total writings.

The **Chairman**. They take a small part, and the largest companies won't have anything to do with the program. It seems to me that that's why we're experiencing the problems we are in right now. The program left largely to those that are not of an equally good reputation and these companies take the lion's share of the business.

Mr. **Bedford**. I would agree. I would also suggest that one thing we not do today is to condemn all the surety attorneys or all the companies involved, because to do so, I think—all we need to do is to look at the proceedings going on over at the Senate. It would be wrong to do so.

I've been involved in the program all but 4 months. I started in 1971, and there have been abuses within the program in underwriting, handling of claims, and certainly even at the Small Business Administration.

I would like to point out that in evaluating the program, it's very important that the members of this committee also be made aware of the great success and cost effectiveness of this very important but ill-treated program.

If the members leave the hearing with only a negative picture, this program will continue to deteriorate, and in the near future will be nonexistent. It would be unfair to those companies that have been very supportive of the program, the contractors and their employees who depend on it, and many other people who have worked so hard on the program.

I don't know of another program in which the gross cost has averaged only $16 million per year, as this program has, yet has done so much good. In fact, there is no net cost to the Government in this program. Government studies have shown that since the inception, the net savings to the Government and taxpayer is in excess of $236 million, and I have the figures in my statement which show that out of—this is through July of 1981—135,000 contracts were indemnified, 23,000-plus contractors were assisted, $10,189,973,000 was the amount of those contracts indemnified, and the savings to the Government and taxpayer, due to the competitive bidding nature, just on Federal contracts, came to $364,764,000. The Government received in income from the surety fees and contractor fees in excess of $46 million. Gross savings to the Government, $411 million. Net claims paid—and I think these are figures back to July, and I've heard a $178 million figure, but back at that time it was $165 million. The net benefit, not including the cost of administration, was $245 million. The cost of administering the program was $9,624,000. Net savings to the Government and taxpayer was $236 million.

The figures do not include those dollars that would be saved by the city governments, county governments and State governments if they were unable to have these additional small companies bidding.

The program has helped 24,000 contractors and performed $10 billion in construction contracts, and I submit that at a time when we're trying to cut Government costs, it seems ludicrous to continue to reduce the efficiency and funding for the surety bond program. Continued reductions in funding will have a serious effect on an already hard-pressed construction industry. According to latest Government figures, the construction industry is now the single largest component of this country's gross national product.

And I do believe that the main problem facing the program is the failure of the top management of the Small Business Administration and the administration to recognize that this program is a separate, distinct, and different program from the loan guarantees. The program normally is underwritten by loan people at the different regional levels. They do not understand how a contractor operates, the importance of cash flow and so on, and as a result that creates difficulty.

I will say—and I certainly agree with the Inspector General, when you consider that less than 70 people administer this program nationwide, and I understand this is the second largest program in the Small Business Administration—compared to over 1,500 in the loan guarantee program—and from what I gather, and from what I read and hear, there is some question on the value of that program—I don't know in that particular program, how often it creates employment and additional taxes being paid by people who are employed. I hope the new leadership of the administration will consider these facts and work toward restoration of the funding needed to allow the surety bond guarantee to continue in a productive manner, which would include, certainly, the necessary claims procedures, as well as underwriting procedures.

I would like to indicate that as a managing general agent for Balboa, I'm also a member of the TASSC association, which is The Association of Specialty Surety Companies, and I know they're going to speak later.

And I would like to address myself to the type of claims handlings that both Balboa Insurance Co. and Morrison Assurance Co.

use in their operations. First of all, we are strong believers in the general status inquiry. A general status inquiry is sent out on a regular basis on every contract or every contractor or every project that we have bonded. These general status inquiries go to the obligees. The obligee is the company or individual to whom the performance by the principal contractor is guaranteed.

We send them to the obligee because we want him to tell us exactly how that contractor is performing his contract. We are in fact soliciting problems.

When the GSI form is returned, it is reviewed for possible negative comments and other areas of potential problems. An investigation of any negative comments may lead to the establishment of any one of three files: A rumble file, an action file, a claims file—and I'll answer any questions on the content and mechanism of those.

Most of the negative comments or problems are resolved by the surety in-house claims personnel without legal expense. Probably 70 percent of all the problems that we become aware of are eliminated prior to their being legal expense, or even the Small Business Administration being aware of them.

If it becomes necessary to actually establish a claims file, the file is reviewed by an in-house claims examiner, and then ordinarily it is only at this time that an outside surety attorney is retained. The in-house claims examiner works closely with counsel to minimize the surety's loss, and in many cases to recover that loss from defaulted contractors and indemnitors. We emphasize taking every reasonable action necessary to maximize recovery from the defaulted contractor and the indemnitors.

These companies do not give draft authority to their attorneys. Although most of the investigation of a claim and the recommendations as to whether or not to pay that claim do come from the counsel, the ultimate decision as to whether or not to pay or settle a claim rests with the surety's in-house claims examiner.

On occasion it becomes necessary to establish a trust account with the surety's local counsel to fund completion of the defaulted contract or to pay project-related expenses. If this is done, a strict accounting is required by the in-house claims department from the surety's local attorney. However, ordinarily drafts are still paid directly by the surety for completion costs.

The companies I represent place a strong emphasis on preventive medicine and avoidance of a claim situation. And in today's forms and presentations, there is a paper that was written by the claims chairman—chairman of the claims committee of the American Specialty Surety Company Association, and I have presented it, and it is "Suggested Preventive Maintenance Procedures for Bonded Claims," and it's available to anyone who would want one.

We do conduct seminars for our underwriters, and we do have experienced surety people talk to them.

I would like to offer four brief and final points of criticism at this time. I think some of them have been covered, but I would say there are inconsistencies from region to region in interpretation and application of surety bond guarantee regulations and policy amendments and these inconsistencies must be eliminated.

The second one is the central office personnel is inadequate to process reimbursements to sureties. The delays in receipt of payments to sureties are exceeding 90 days. This is one of problems over which Morrison Assurance Co. left the program.

Third, monthly statements for surety fees from the Denver office of the Treasury are usually late and replete with errors. Items are being billed to the wrong sureties and are not corrected by the Small Business Administration for months, resulting in delayed receipt of Government revenues. Not only is the Government slow in paying sureties, but they are also slow in collecting funds due to the Treasury.

And, lastly, the regional office underwriting should be limited to compliance with regulations. This is a recommendation: There should be no subjective analysis nor primary underwriting by the regional offices. The Small Business Administration should underwrite the surety, and not each individual bond submission. The purpose of the program is to strengthen the role of the private sector, particularly small business, in order to increase jobs and cut the rate of growth in Federal spending.

And in one other area, I would like to comment on Mr. Douglas' comments on the Treasury. I will point out that—and I have to agree with him, because I believe that if he had attempted to restrict AFFI from being on the Treasury list, then he would have had to have gone to U.S.F. & G., the Aetna, and INA, because the only difference is that they buy reinsurance. They go to a reinsurance carrier, and they buy reinsurance, and certainly they'd like to have a 40 percent loss ratio. I can't remember the last time they've ever had it. A few years ago, their loss ratio was in excess of 100 percent.

And to say to the Treasury Department that they should take AFFI off the Treasury list is to have AFFI probably turn around and say, "Wait a minute. With our reinsurance," or whatever you want to call it, "from the Small Business Administration, our loss ratio certainly is acceptable, and our assets allow us to be on the Treasury list." And I think that you have to understand that there is a fee that is paid to the Small Business Administration, and you can call it the indemnity or reinsurance or whatever, but I think there is a problem, and if you can solve it, fine, but I believe the Treasury is correct, in that they would have to look at any other surety that without reinsurance the loss ratio would be bad.

I thank you for the opportunity to be heard, and I hope to answer any questions the committee members might have.

The CHAIRMAN. Well, would you like to compare Balboa with AFFI, as far as loss ratio is concerned?

Mr. BEDFORD. I don't know what AFFI's loss ratio is. You mentioned a 60 percent ratio. I don't know whether you mean a ratio of number of bonds that have gone into claim based on the number of bonds written. I can only indicate that Balboa has been in the program probably approximately the same length of time, and their loss ratio, I feel, is certainly acceptable.

To underwrite this program, Senator, to—if we looked for a reason not to write a bond for these small contractors, we would not write any, and we need to simply determine, are they capable of doing the job, and then we need to try to help them find a way to do it, and that's what we try to do.

And the loss ratio of Balboa is not available to me, but I think you probably have that somewhere.

The **Chairman**. In the documents that the chief counsel shows me, losses are determined by the ratio of losses incurred to premiums earned. For the surety business of AFFI it is a loss vote of 61.7 percent, and for Balboa it is a loss vote of 4.5 percent. (See exhibit V beginning at p. 470.)

Mr. **Bedford**. 4.5 percent as opposed to—again, I'm——

The **Chairman**. As compared to 61.7.

Mr. **Bedford**. Senator, I question whether—we may be talking about apples and oranges. If in fact their loss ratio was 4.5 percent, then you'd be indicating that their gross loss ratio was 45 percent, prior to indemnity, and I assure you, there isn't a surety company around that I know of that is able to write, in the economic times that we have, a loss ratio of that, so——

The **Chairman**. Do you want to show that to him?

Mr. **Haynes**. Yes, I would.

Mr. **Bedford**. It may be that if the 4.5 indicates that out of 100 bonds written there are four-and-a-half bond claims, that might be more in line, but—I would say that I'm very happy to be representing the Balboa. [Laughter.]

[Pause. Mr. Bedford is shown the Argus loss ratio chart which shows the annual losses of AFFI as compared to Balboa.]

The **Chairman**. You're right.

Senator **Rudman**. Why don't we leave it right there, Mr. Chairman. [Laughter.]

The **Chairman**. Just two questions. Senator Rudman has indicated he has none. The Inspector General also testified to abuses in the claims adjusting area. How can SBA prevent fraud in these completion contracts?

Mr. **Bedford**. I would say, Senator, that—well, I don't know that the Small Business Administration can come forward with claims guidelines on their own that would allow the surety companies to be able to adjust claims or have claims adjusted without being totally afraid of mishandling or being accused of mishandling.

I think that if the industry—and I mean attorneys as well, who have the surety experience like another gentleman who will speak later—I think that some guidelines can be established. I think that a much closer relationship between the attorneys working on the projects or on the claims with the surety companies is important, and I don't believe that the Small Business Administration has enough personnel to be as involved as they would like to be, and I think they certainly should be.

So I'm afraid to think what would happen if we had to close the program down for 4 weeks, as Senator Rudman suggested. The people who would be hurt would not be surety—this is the time of the year when a lot of contractors are making their work program for this coming year, and it would be chaos for them.

But guidelines can be established, as long as they're reasonable and as long as the Small Business Administration is aware that the guidelines must mesh with the handling of the claims by the different surety companies.

The **Chairman**. What of the idea that I suggested earlier, that the time had come to get some outside consultants who know about the insurance business and get them into SBA to set up that part of the——

Mr. **Bedford**. I think it's an excellent idea. I would suggest that if you do that, that those people come from within the industry that's supporting this program, and I mean the specialty surety companies, because when you're dealing with the standard companies who have an office on every corner throughout the Nation, that's one thing, but they're not supporting the program. And when you've got Balboa sitting out at Newport Beach trying to handle a claim in Boston, Mass., there is no way that they can handle that with in-house people. There's no way they know what the regulations and laws are that pertain to surety in that given State.

So if this is done, then there needs to be someone who really understands this program and the problems that any guidelines that would be set up would cause in the normal operation of the program. And with that, I think it's an excellent idea.

The **Chairman**. Thank you very much.

[The prepared statement of Mr. Bedford follows:]

STATEMENT BY
MOUNTIE M. BEDFORD, PRESIDENT

M B UNDERWRITERS, INC.
P.O. BOX 15350
PENSACOLA, FLORIDA 32504

BEFORE THE
UNITED STATES SENATE SMALL BUSINESS COMMITTEE

Mr. Chairman, my name is Mountie Bedford. I am President of M B Underwriters, Inc., a general agency representing Balboa Insurance Company, the largest single writer of bonds in the Surety Bond Guarantee program. Prior to representing Balboa, I was general agent for Morrison Assurance Company, Inc., of Mobile, Alabama. To my disappointment, Morrison withdrew from the Surety Bond Guarantee program in December, 1981. They had participated in the program for over five years and had written a substantial volume of bonds.

The Surety Bond Guarantee program began in July, 1971. I became involved in writing bonds in the program only four months later. During this time, I have heard of different abuses within the program at all levels including underwriting, handling of claims, and even at the Small Business Administration level.

I have heard that todays meeting is primarily to discuss abuses within the Surety Bond Guarantee program. If that is the case, the committee is to be commended, because there are abuses which exist, and the program does need improvement. However, in evaluating the program it is important that the members of this committee also be made aware of the great success, and cost effectiveness of this very important but ill-treated program. If the committee members leave this hearing with only a negative picture, the program will continue to deteriorate and in the near future will be nonexistent. This would be truly unfair to those many small contractors and their employees who depend on the program and the many people who have worked so hard to make the program a success.

I can honestly say that I have never heard of a government program, the gross cost of which has averaged only sixteen million dollars per year, at this program has, that has done so much good. In fact, there is no net cost of this program. Government studies have shown that since inception the net savings to the government and taxpayer from the Surety Bond Guarantee program is in excess of two hundred thirty six million dollars. The most recent study by the government has shown the cost effectiveness of Surety Bond Guarantee as follows:

July 1, 1971 through July, 1981:

| | | |
|---|---|---|
| Number of contracts indemnified | 135,439 | |
| Number of contractors assisted | 23,493 | |
| Total dollar value of contracts indemnified | | $10,189,973,000.00 |
| Savings to government/taxpayer due to competitive bidding | | $ 364,764,000.00 |
| Income to government from surety and contractor fees | | $ 46,259,818.00 |
| Gross savings to government | | $ 411,023,818.00 |
| Net claims paid | | $ 165,355,000.00 |
| Net benefit of program exclusive of cost of administration | | $ 245,668,881.00 |
| Cost of administration | | $ 9,624,000.00 |
| Net savings to government/taxpayer | | $ 236,044,881.00 |

The above figures have provided the government and taxpayer with a net financial benefit annually in excess of twenty three million dollars per year. It is important to note that these figures do not include additional savings to state, county, or city governments when their construction contracts are put out for competitive bids. Also, these figures do not include savings due to increased employment and consequently increased payment of taxes. This program has helped twenty four thousand contractors to bid and perform over ten billion dollars in construction contracts at no net cost to the government.

At a time when our leadership is trying to cut government cost, it seems ludicrous to continue to reduce the efficiency and funding for the Surety Bond Guarantee program. Continued reductions in funding will have a serious effect on an already hard-pressed construction industry. According to latest government figures the construction industry is now the single largest component of this country's gross national product.

I believe that the main problem facing the Surety Bond Guarantee program today is the failure of the top management of the Small Business Administration and the Administration to recognize Surety Bond Guarantee as being separate, distinct, and different from the loan guarantee program. Its position on the priority list has always been low, yet I understand that in dollar amounts, that guarantees indemnified by Surety Bond Guarantee are second only to the Small Business Administration bank loan program. When you consider that less than seventy people administer the Surety Bond Guarantee program nationwide, compared to over fifteen hundred in the loan guarantee program, the cost effectiveness of Surety Bond Guarantee is apparent. I hope that the new leadership of the Small Business Administration will consider these facts and work toward restoration of the funding needed to allow the Surety Bond Guarantee program to continue in a productive manner.

Having advised the Committee of what I perceive as the substantial overall benefits of this program to the government, I would like to now address myself to specific procedures employed by the companies that I have represented in their handling of both potential and actual bonded defaults. Both Balboa Insurance and Morrison Assurance use General Status Inquiries (GSI). A General Status Inquiry is a periodic request for information regarding the current status of a principal contractors performance on a bonded construction project. These GSI's are sent to both obligees on a regular basis through the length of the project. (An obligee is the company or individual to whom the performance by the principal contractor is guaranteed.) By undertaking these periodic inquiries, the companies are soliciting comments, both good and bad, concerning the performance [illegible] the bonded contractor on the project.

When the GSI form is returned by the obligee, it is reviewed for possible negative comments and other areas of potential problems. An investigation of any negative comments may lead to establishment of anyone of three types of files: (1) a rumble file; (2) an action file, and (3) a claims file. If the Committee has any questions regarding the content or mechanisms employed in establishing these files, I would be pleased to answer questions after my statement.

Most of the negative comments or problems are resolved by the Surety in-house claims personnel without legal expense. This procedure occurs most often in the rumble and action file. If this becomes necessary to establish an actual claims file, the file is reviewed by an in-house claims examiner and ordinarily it is only at this time that an outside surety attorney is retained. The in-house claims examiner will work closely with counsel to minimize the surety's loss and in many cases to recover that loss from the defaulted contractors and indemnitors. We emphasize taking every reasonable action necessary to maximize recovery from the defaulted contractor and the indemnitors.

The companies do not give draft authority to their surety attorneys. Although most of the investigation of a claim and the recommendations as to whether or not to pay that claim is made by local counsel, the ultimate decision as to whether or not to pay or settle a claim rests with the surety's in-house claims examiner.

On occasion it becomes necessary to establish a trust account with the surety's local counsel to fund completion of the defaulted contract or to pay project related expenses. If such an account is established, strict accounting is required by the in-house claims department from the surety's local attorney. However, ordinary drafts are paid directly by the surety for completion costs.

The companies that I represent have placed a strong emphasis on preventive medicine and avoidance of a claim situation. For example, we asked the chairman of the American Specialty Surety Counsel Claims Committee to present a paper to our agents at a seminar in Tampa, Florida, approximately two years ago. I have with me today a copy of that paper titled "Suggested Preventive Maintenance Procedures for Bonded Claims", and I have attached a copy of that paper to my written statement for the Committee's convenience.

The companies use of General Status Inquiries and periodic seminars for local underwriters evidences and emphasizes our dedication to avoiding a claim before it begins. However, on occasions a claims situation is unavoidable. In that event, the file is referred to our local surety attorney for primary handling. We have found this procedure to be the most successful method of minimizing loss.

I would like to offer four brief and final points of criticism at this time:

(1) There are inconsistencies from region to region in interpretation and application of Surety Bond Guarantee regulations and policy amendments, and these inconsistencies must be eliminated.

(2) The central office personnel is inadequate to process reimbursements to sureties. The delays in receipt of payments to sureties are exceeding ninety days. This problem is one of the main reasons Morrison Assurance Company left the program.

(3) Monthly statements for surety fees from the Denver office are usually late and replete with errors. Items are being billed to the wrong sureties and are not corrected by Small Business Administration for months resulting in delayed receipt of government revenues. Not only is the government slow in paying sureties but they are also slow in collecting funds due to the treasury.

(4) Regional office underwriting should be limited to compliance with regulations. There should be no subjective analysis nor primary underwriting by the regional offices. The Small Business Administration should underwrite the surety and not each individual bond submission. The purpose of this program is to strengthen the role of the private sector, particularly small business, in order to increase jobs and cut the rate of growth in federal spending.

Mr. Chairman, thank you for the opportunity to be heard and I hope to answer any questions the committee members might have.

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March 9, 1982

Mr. Mountie Bedford
M B Underwriters
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Dear Mountie:

In our recent series of telephone conversations and meetings, you requested my views as Chairman of the Claims Committee of The American Specialty Surety Council regarding the propriety of the policy of specialty surety companies in employing local outside counsel to handle bond claims. You also requested my views on methods and procedures which might be employed to avoid abuses in the claims handling process such as fraud. Of course, the following explanation is only my opinion, and I do not speak for all or any of the specialty surety companies who are either members of TASSC or whom I represent.

It must be remembered that common law rules of suretyship and statutory provisions relating to the surety field vary substantially from state to state. In my view, it would simply not be economically feasible for a small specialty surety company to employ a staff of attorneys sufficiently diversified as in-house counsel for the handling of bond claims. It must be remembered that many companies write in all fifty states and that each of those states are governed by different principles and specific case law. Of course, there are many principles common to a majority of the states. However, for any staff of less than ten (10) attorneys to remain conversant with changing case law and legislation in all fifty states, plus federal legislation and case law, seems to me to be, if not impossible, certainly very nearly so.

The specialty surety bond program is a small dollar volume industry. Any efforts to centralize claims handling by staff attorneys would have to originate from a particular surety company's home office. There is certainly not a sufficient dollar volume of premium to justify satellite offices solely for specialty bond claims attorneys. Therefore, the cost of travel and lost time in connection therewith would have to be included in any analysis of the feasibility of centralized bond claims handling. Under the existing system local counsel routinely visit jobsites and meet with obligees, principals, subcontractors, material supply claimants, Internal Revenue Service agents and other governmental authorities involved with various bond defaults. All of these endeavors by local counsel are geographically oriented, particularly with respect to jobsite inspections which, in many cases, are absolutely necessary for proper remedial recommendations to the surety. Even a staff of 10 to 15 counsel centrally located would be severely taxed to accomplish these services throughout the United States. The expense of travel alone would far exceed the present cost of local counsel geographically disbursed and retained on an hourly basis.

Furthermore, were these duties delegated to central office claims personnel, the additional costs thereof would become fixed administrative costs not allocable to a particular bond default and therefore not recoverable by way of indemnity. This latter point reaches the very heart of the underlying philosophy of principal and surety relationship. The contract of suretyship and the premiums charged therefor contemplate the surety's total indemnification by the principal and by the individual indemnitors upon whose credit the bond is issued and whose default has occasioned the loss. This philosophy is implemented by allocating the costs of a particular default, (including investigation and defense of the surety) to a particular bond and recovering this loss from the signatories to the General Indemnity Agreement. Rightfully, parties who actually default on a bond should bear the burden of administering the default and processing the claims.

If the entire cost of processing and handling claims is a fixed cost to the company, there would be no allocable loss recoverable from those solvent indemnitors who do have a financial interest in the defaulted principal contractor. Admittedly, not all losses are reimbursed through indemnity. However, it is unjust to require a surety (and through increased premiums, its non-defaulting principals) to bear the cost of administering and paying claims under a defaulted bond, when by allocating these costs to the particular defaulting principal, indemnification can be accomplished.

In addition to cost and the just allocation of costs, the speed and efficiency of a surety's response is also an important factor. Frequently, it is important that an immediate investigation or immediate action be taken in connection with a default or alleged default. It is inconceivable that even a staff of ten to fifteen lawyers in the home office could timely respond nationwide. Most specialty surety companies have at least one law firm which represents them in every state. Frequently, there is more than one law firm in any given state which represents a particular surety, and there may be several attorneys in each firm who handle these cases. Therefore, it is unrealistic to presume that any kind of reasonable size legal staff could handle all of these problems in an expeditious manner so as to minimize losses.

Even if it could be shown that claims processing costs would be reduced by enlarged home office administration of claims it most surely would be at the price of increased losses to the sureties as a result of poor quality administration of claims. I do not believe that it is possible for home office administration to provide the kind of local knowledge and attention to detail which is necessary to minimize losses. For example, in negotiating a bond default on behalf of one of my clients, I was dealing with an attorney representing the obligee and located in Maryland. Pursuant to a particular provision of the Georgia Code, (which provision is somewhat obscure and little publicized) I made a demand on behalf of the surety which required an appropriate response on the part of the obligee and their Maryland attorney. Apparently, as a result of the Maryland attorney's lack of knowledge of this particular provision, the obligee failed to comply with my demand. Although the case remains in litigation at this time, it is my opinion that ultimately, the surety will prevail based upon this demand and the subsequent technical defense arising therefrom, thereby relieving the surety of a potential obligation of approximately $225,000.00. The chances are relatively remote that a home office attorney based in, say, California, who handles bond claims in at least five other states would be sufficiently familiar with the Georgia Code to assert such a defense. Of course, this conclusion is partially conjecture on my part. However, the technicalities and intricacies of each state's laws do not lend themselves easily to assimilation and usage by counsel attempting to handle what, in my view, is too extensive and diversified a case load to properly represent the surety and to minimize loss.

It should be pointed out that familiarity with local court practices, knowledge of people serving locally on juries, certain tendencies and idiosyncrasies of particular judges and courts can, in the long run, prove to be a valuable tool in minimizing a surety's loss or prevailing in litigation relating to a bond claim. I believe even the most ardent critic of current procedure would have to agree that the advantage realized from the knowledge of these matters is virtually incalculable. Of course, this line of reasoning, taken to its logical extreme, would require the surety to employ a different attorney in perhaps every county of every state where a bond claim occurs. The utility of knowledge of local rules, procedures, and personnel must be balanced against the surety's interest in having all of the defaults of a particular principal administered by a central attorney. By choosing one or possibly two attorneys within any given state, the surety can be assured that recommendations or decisions in connection with the handling of a given case take into consideration these local rules, procedures, and personnel, as well as the complexities of other claims against the same principal.

The question of preventing abuses or fraud in the claims handling process is, in effect, a much more difficult question to address if only for the reason that I can provide you with my opinion and explanation regarding the justifiable use of local outside counsel for handling bond claims, and I believe that I can justify that procedure very well indeed from many aspects. However, I cannot, nor can anyone else, provide you with a foolproof method of avoiding all abuses and all fraud in the claims handling process.

The first potential area for abuse in the claims handling process, believe it or not, comes from the defaulted principal contractor. A defaulted principal contractor is usually in the midst of many difficult financial problems. It would appear to be only human nature that some of those defaulted contractors would turn to fraud as a way of attempting to avoid the financial difficulties currently being experienced by the contractor. For example, a defaulted contractor who knows that he will probably ultimately be required to file bankruptcy after a default may go to one of his subcontractors or material suppliers and agree to advise the surety of the existence of a fraudulent claim in favor of that subcontractor or supplier against the defaulting contractor himself, and his surety. Of course, since the contractor is defaulted and insolvent usually, the surety would ultimately pay the bill. Notwithstanding the defaulting contractor's indemnity obligation to the surety to indemnify the surety from any loss occasioned by the execution of the bond in question, the principal might nevertheless plan to "pocket" a substantial amount of money and flee or attempt to hide his assets. The principal contractor might approach the subcontractor who has a claim of say $5,000.00 and agree to advise the surety of the existence of a claim in favor of that subcontractor in the amount of $10,000.00 provided that, for example, the subcontractor would share the fraudulent portion of the claim with the principal contractor. Because of the existence of this area for potential abuse, as a matter of practice, our law firm almost never accepts as verification of a claim of a material supplier, subcontractor, or laborer, the bare assertion by the defaulted principal contractor that the subcontractor, material supplier, or laborer is owed a particular sum of money. That is to say, we require independent documentary verification of the claim. Naturally, documentation can be forged. However, it has been my experience that the more difficult that it can be made to document a claim from a subcontractor or supplier, the more difficult it would be to fraudulently prepare documentation of such a claim. For example, if a material supplier has a claim submitted in the amount of $10,000.00, we require not only copies of invoices from the supplier but also delivery tickets identifying the project to which the materials were supplied and bearing the signature of an employee of the principal contractor acknowledging receipt of the materials on the site. We then verify that the signature in question is in fact the name of an individual who worked for the principal contractor. Usually, the person receiving materials at the project site will not necessarily, and usually is not, the owner of the defaulted principal contractor, and therefore, an additional party has to become involved in any kind of fraudulent submission of delivery tickets. Of course, once again, this procedure is not foolproof.

However it makes difficult effort by the defaulting principal contractor to obtain a "kickback" from his subcontractors or material suppliers. The requirement of delivery receipts does reduce the possibility for such fraudulent activity.

In connection with the claims of material suppliers and subcontractors, we attempt to verify that the type of material sold and identified in the invoice and delivery tickets are the type of materials which would be, in fact, needed for the type of construction project bonded by the surety. For example, on a project at the Federal Law Enforcement Training Center in Brunswick, Georgia, a client of mine executed a labor and material payment bond. Several claims were submitted by various subcontractors and material suppliers. A portion of the claim of one of the material suppliers was for pine paneling. I was able to verify from discussions with the government project manager, and from an examination of the contract documents that the contract in question did not require any type of wood paneling. For that reason, we concluded that the materials were not in fact supplied to the project bonded by my client and that portion of the claim was denied. Of course, the submission of that portion of the claim might very well have been an honest mistake on the part of the material supplier. However, some less scrupulous material suppliers would be willing to submit claims for materials sold to a defaulted principal contractor on unbonded projects as claims against bonded projects.

Another area of potential abuse by the material supplier is in the area of application of payments received prior to the default from the defaulting principal contractor. Frequently, the material supplier will be supplying materials to the principal defaulting contractor on bonded as well as unbonded contracts. There is always a danger of the material supplier revising his accounts receivable ledgers on each project to reflect that payments received on bonded projects were actually applied to unbonded projects, thereby reducing the material supply claimant's exposure on unbonded projects for which he does not expect to be paid since the principal contractor appears to be insolvent, and increasing the surety's potential exposure to the material supplier. This procedure of misapplication of payments does not require the complicity of the defaulting principal contractor. Frequently, the defaulting principal will not even be aware of precisely how much money is owed to a material supplier on a project. For these reasons, we always require a copy of the material supplier's accounts receivable ledger dating back just prior to the time when materials were first supplied to the bonded project and going through the current date. Of course, once again, a fraudulent accounts receivable ledger could be prepared by the material supplier, however, on many occasions we have discovered misapplication of payments by material suppliers through an examination of their accounts receivable ledger, thereby reducing the surety's potential exposure to the material supply claim.

As in the case of material suppliers, we attempt to verify that a particular subcontractor to a defaulting principal contractor had no other subcontracts with the principal on unbonded projects. If other contracts were in existence, we attempt to verify the status of those contracts and whether or not any payments received on the bonded projects may have been misapplied to unbonded subcontracts. Also, we attempt to verify that a subcontractor is providing the type of services needed on the bonded contract. For an extreme example, a roofing subcontract would appear suspect on a bonded grading and pipeline contract.

In connection with the surety's performance obligations for completion of construction contracts a slightly different problem is faced. First, the surety is somewhat at the mercy of the contractor who replaces the defaulting principal and completes the contract on behalf of the surety. In order to avoid excessive prices from the replacement contractor, competitive bidding is ordinarily the best method of obtaining a replacement contractor. Except under very exceptional circumstances, we require at least three bids from three different reputable contractors. These bids are submitted in writing to our office as attorney for the surety. The bids are examined for conformance with the work requested, and we almost always require that the replacement contractor provide the surety, as obligee, with a performance and labor and material payment bond assuring performance and payment by that replacement subcontractor. There are limited circumstances under which competitive bidding is not or should not be employed. For an extreme example, take a $100,000.00 contract which is 99% complete. The bonded contract under this hypothetical situation is the electrical subcontract and the entire project cannot be accepted or utilized by the owner until the electrical work is completed. The general contract in this hypothetical situation might very well provide for liquidated damages in the amount of $2,000.00 per day for delayed performance. If time is absolutely imperative and of the essence, the expeditious utilization of a local electrical subcontractor, even on a cost plus basis might prove to be more economically feasible than taking the necessary time to obtain three separate bids to do approximately $1,000.00 worth of work. Of course, this is an extreme example, but the point is that the surety should have the flexibility to decide not to obtain competitive bids in limited circumstances. The absence of utilization of competitive bidding in most cases certainly lends itself, if not to fraud, at least to possible price gouging on the part of the replacement contractor.

There is less protection available to the surety in the event that that surety's attorney conspires with a replacement subcontractor to either rig bidding or to inflate the price to be charged by the replacement subcontractor. Therefore, Competitive bidding which ~~[illegible]~~ requires collusion on the part of more individuals ~~[illegible]~~ should be encouraged. However, the best line of defense against such a possibility is to employ reputable and competent counsel, specializing in the surety field, whose integrity is perceived to be beyond reproach. Obviously, there are dishonest people in every field of endeavor. However, in my view, no profession has tried any harder than the legal profession to police itself and rid the profession of dishonest or unethical attorneys.

I trust that the foregoing will be of some assistance to you. If I can provide you with any further information, please feel free to contact me.

Yours very truly,

DeWitte Thompson

## SUGGESTED PREVENTIVE MAINTENANCE PROCEDURES FOR BOND CLAIMS

### Introduction

There are certain procedures which can be undertaken by agents and bond underwriters prior to the occurrence of a bond default which can result in substantial savings or reduction of a surety's loss incurred in connection with the issuance of a construction contract bond. The purpose of this paper is to briefly outline some of those procedures which should be of some assistance to the claims department and claims attorney representing the surety. The list of suggestions contained in this paper is by no means comprehensive or complete.

### Collateral Security

Ordinarily, performance and labor and material payment bonds are issued on behalf of a contractor as a principal based primarily upon the contractor's technical expertise and apparent financial condition. Obviously, an underwriter does receive financial information from a contractor on occasion which does not meet the underwriter's expectations or standards. This problem arises with some degree of frequency with smaller contractors whose only source of bonding capacity is through the Small Business Administration Bond Guarantee Program.

Once the determination has been made that the bond will not be issued for a contractor without collateral security, the underwriter must address several issues:

(1) What is the form of the collateral?
(2) What is the value of the collateral?
(3) How can the surety's interest in the collateral be protected?
(4) What are the remedies available to the surety if it becomes necessary to pursue the interest in the collateral?

The fourth question is of importance to the agent or underwriter only for the general purpose of determining the acceptability of the risk to be undertaken by the surety. The agent is not and should not be expected to evaluate the precise legal remedies available to the surety, or the procedure whereby they may be exercised. The agent should be aware as to whether the surety would be in a position to merely write a letter to obtain cash for the collateral, or whether it might be necessary for the surety to initiate extensive legal proceedings to enforce rights against the collateral.

There are two basic forms of collateral: real property and personal property. The manner of perfecting an interest to either of these forms of collateral is governed by the law of the state within which the property is situated. Ordinarily, a mortgage, security deed, or trust deed will be executed by the principal or individual indemnitors to convey an interest in real property to the surety. In most states, the execution of that instrument, however it may be designated, will perfect the surety's right against the principal or individual indemnitors granting the surety the interest in the real property. However, all states require that in order to protect the surety's priority interest against third parties, an appropriate filing must be made in deed records designated by state law. The agent should not attempt to evaluate whether or not the principal or indemnitors have clear title to the real property, whether the instrument of transfer is appropriately executed, or the appropriate office for filing and recording of the document. A local attorney should be consulted with regard to all of these issues.

Fortunately, the agent is more often confronted with the offer of personal property from the principal or indemnitors as collateral security for the issuance of a bond. In the event that personal property is offered, after an initial briefing from a local attorney, the agent should usually be sufficiently knowledgable to arrange for the perfection of the surety's interest in and to the personal property collateral.

Unfortunately, the term "personal property" encompasses virtually everything other than real estate and the fixtures thereto. However, there are some elements common to the creation of the surety's interest in various forms of personal property collateral.

The Uniform Commercial Code (which has been adopted in all states except Louisiana) provides that a security interest in personal property is created by a process known as "attachment". In order for an attachment to occur, there must be an agreement between the parties (surety and transferor of the interest) in writing which, for value given, grants to the surety a secured interest in the debtor's property. The general agreement of indemnity provides the surety with such a writing. However, most sureties, including Morrison's, have a specific form for a collateral security agreement. This agreement is intended to supplement the terms of the general agreement of indemnity. Also, the general agreement of indemnity is not ordinarily signed by the surety. As in the case of an executed mortgage, the executed security agreement establishes the existence of the security interest between the parties to the agreement only.[1] To render the security interest immune from attack by third parties, such as judgment creditors or trustees in bankruptcy who may be seeking the debtor's assets, the security interest must be perfected.[2]

Perfection is ordinarily accomplished by either of two means. The secured party may either take possession of the collateral, or file a financing statement in the appropriate official records.[3] Both of these procedures for perfection are designed to give third parties notice of the existence of the security interest.

Taking possession of collateral to perfect a security interest is known as a pledge. The pledge has two advantages over filing a financing statement: first, no filing is required in order to perfect an interest; second, notwithstanding the explanation of attachment as stated above, a written security agreement is not required to attach the security interest. Obviously, perfection of a security interest by possession is frequently not a viable alternative.

The collateral cannot be in the hands of the debtor or person controlled by the debtor. It must be in the possession of the secured party or his agent. Therefore, it is seldom feasible to take a pledge of inventory, equipment, or consumer goods, since the debtor needs to retain possession of such assets and the secured party, taking possession of such assets, would usually limit the operating capacity of the contractor/debtor. Also, there are limited circumstances wherein a pledge cannot be used to perfect a security interest. Perfection of a security interest cannot be accomplished in accounts receiveable or general intangibles by taking possession thereof. "General intangibles" is a legal term which encompasses good will, literary rights, copyrights, trademarks, or patents. Likewise, there are certain types of collateral in which a security interest can be perfected only by possession of the property. Possession is the only way to perfect a permanent security interest in instruments. "An instrument" is defined in the Uniform Commercial Code as a negotiable instrument or a security or any other writing which evidences a right to the payment of money and is not itself a security agreement or lease and is of a type which is, in ordinary course of business, transferred by delivery with any necessary endorsement or assignment.[4]

Although possession is the only way to permanently perfect a security interest in instruments, a security interest may be protected temporarily without filing or possession. In order to achieve temporary perfection, a written security agreement must be executed and the collateral must be given for new value. That is to say, a temporarily perfected security interest may not be obtained in instruments to serve as collateral for bonds written prior to the execution of the security agreement. Further, a substantial limitation upon temporary perfection is that possession must be taken by the secured party within 21 days for the purpose of ultimate sale, exchange, presentation, collection, or renewal, registration or transfer.[5]

Frequently, the surety's agent will take a security interest in letters of credit, instruments, or negotiable documents. These items are probably the most practical form of collateral security. Their delivery to the surety's agent eliminates the need for determining the location of a filing, and the perfected interest continues as long as possession is retained. In many states, a security interest perfected only by filing is limited in duration and must be refiled after a certain period of time. Also, provided that the surety has an appropriate power of attorney, as contained in a general agreement of indemnity or collateral security agreement, instruments, negotiable documents, or letters of credit are considerably more liquid and readily available for disposition in the event of a default by the principal.

If a security interest is taken in personal property other than letters of credit, negotiable documents, or instruments, the most practical method of perfecting the surety's interest in that property is by filing a financing statement. The financing statement is sufficient under the laws of most states if it gives the name of the debtor and the secured party, is signed by the debtor, gives an address of the secured party from which information concerning the collateral may be obtained, and gives the mailing address of the debtor. This statement must also contain a statement indicating the types of collateral or describing the items of collateral.[6] The description of the collateral need not be so detailed that it encompasses the serial numbers of equipment or the like. It is not necessary to disclose all of the details of the transaction giving rise to the security interest on the financing statement. The only purpose of the financing statement is to give notice to third parties that a security interest does exist. The obligation is then incumbent upon the third parties to discover the exact dimensions of the security interest by conferring with the parties.

An initial consultation with a local attorney should provide the agent with sufficient information to determine the location and procedure for filing financing statements. Also, the local counsel should be consulted in the event that a security interest is sought to be perfected in crops, minerals, or accounts generated by the sale of crops or minerals.

A security interest in an automobile may be perfected only by a notation upon the certificate of title. A security interest in an aircraft is governed by the Federal Aviation Act. To comply with the Federal Aviation Act, a financing statement must be filed with the Central National Registry of Aircraft Registration in Oklahoma City, Oklahoma. Accepting automobiles or airplanes as collateral security is generally not recommended, as almost inevitably, a security interest already exists in favor of a lending institution, and the surety's security interest, although perfected, is subordinate to the previously perfected interest of the lending institution.

Instructions for the use of and proper filing of perfected security interests in collateral security will be forthcoming from Morrison's Underwriting Department. Notwithstanding those instructions, the underwriter should always keep in mind the fact that the perfection of a security interest in collateral security can sometimes be a complex undertaking. Therefore, when the underwriter is in doubt, local counsel should be sought. Also, if any doubt exists as to the proper location of the filing, multiple filing should be undertaken by the underwriter to achieve perfection of the security interest under all possible circumstances.

## Bad Faith

The surety, particularly the compensated surety, is no longer viewed in a favored status in the eyes of the law. In today's ever-increasing trend toward favoring and protecting the consumer, the implied duty to act honorably and in good faith in handling bond claims should be of paramount consideration to all parties representing the surety in any capacity. In the past, bad faith claims against insurance companies have been largely limited to areas such as health and accident, life, fire, and liability. However, there has been a recent series of decisions at the trial level upholding bad faith or tort claims against surety companies. The surety has been held liable to the principal for wrongfully freezing the principal's progress payments.[7] On May 5, 1978, a jury in Indianapolis, Indiana granted a $10 million-dollar award for exemplary damages against Fidelity and Deposit Company of Maryland.[8] The award was granted to the obligee on a performance bond. The apparent basis of the jury award related primarily to an alleged lack of investigation by Fidelity and Deposit prior to a denial of the obligee's claim under the performance bond. There was no other apparent basis for the imposition of exemplary damages against the surety. Fortunately, the so-called "Pyramids" case will not furnish any legal precedent, because after the verdict, the case was settled, and therefore, no appellate opinion will be rendered.

As a result of the cases cited above, the compensated surety finds itself in the position of owing a good faith duty to parties usually on opposite sides of a dispute. This dual obligation places additional emphasis upon the importance of the agent's contact and handling of potential claims or disputes involving the principal and obligee or other beneficiaries under the principal's performance or payment bonds.

Some of the more obvious guidelines are set out in this paper. Obviously, every contractor will, at one time or another, become involved in a dispute with a material supplier, subcontractor, or obligee. It is further apparent that economic and manpower limitations dictate that every call from a disgruntled subcontractor or obligee can not be referred to the surety's home office for handling. When in doubt, the agent should refer any claim or potential claim to the surety's home office for disposition.

It is relatively safe for the agent to insist upon some type of written confirmation of the alleged claim. This procedure not only documents the agent's file, but also can discourage the pursuit of a non-meritorious claim by a "hot-headed" subcontractor. This procedure further prevents any possibility that the initial assertions by the claimant will be garbled or accidentally misrepresented to the company's home office.

It goes without saying that no verbal representations should be made to any claimant except that the claim will be forwarded to the surety's home office for response and that an investigation will be undertaken. It is a good practice to confirm all verbal representations made to a claimant in writing. As a practical matter, a form response letter could be easily devised to confirm the agent's verbal representations.

The claims information should be forwarded promptly to the surety's home office. When the claim is forwarded promptly, more time is available to the home office to investigate and respond to the claimant's allegations. The "Pyramid" case found that the surety acted in bad faith as a result of a failure to investigate. It is a well accepted principle in the insurance industry that a failure to make a timely investigation could, under appropriate circumstances, constitute bad faith.[9]

A preliminary fact-finding investigation could be conducted on behalf of the surety by the agent. However, caution should be the watchword of that investigation, and from an abundance of precaution, it is recommended that only the principal be contacted to determine the principal's position with regard to the alleged claim. No action should be taken by the agent to freeze contract funds, nor should any representations be made to any parties other than the home office regarding the alleged claim submitted. As with the claimant, the agent should request that the principal likewise state his position with regard to the alleged claim, in writing.

To briefly summarize the agent's position, he can best avoid any responsibility for any claims of bad faith or interference against the surety by deferring all representations and decisions with regard to claims or potential claims to the surety's home office for handling by professionals equipped to deal with the myriad of problems which can arise from not only disputed claims, but even the handling of valid claims. Secondly, the agent should fully document his file in writing, both confirming telephone conversations with memorandum to the file and by letter to any potential claimant.

Contract Documents

Most bond forms incorporate the contract documents by reference. Although the bond may limit the surety's responsibility under the contract in certain circumstances, the better procedure for the determination of the feasibility of the risk undertaking is by an examination of all contract documents. Very few bond underwriters are architects or engineers, and therefore, an actual examination of the plans themselves will, in most cases, lend very little additional information to the decision-making process. However, it is the better practice to obtain a copy of the contract itself and, at least temporarily, a copy of the contract specifications and general conditions. There are several "standard form" contract and subcontract forms. Regardless of form, most contracts or subcontracts will likely contain many of the same type of clauses.

The first, and probably most important clause contained in the contract is the "scope of the work" clause. Frequently, for the purpose of speed and simplicity, an attempt is made to describe the contractor or subcontractor's work by simple reference to bid line items, or in the case of a subcontractor, to general divisions of the contract work. While the above described divisions and definition of the work are frequently satisfactory, the entire contract itself should be completely reviewed to determine the various parties' respective responsibility for temporary utilities, clean-up, and site conditions. Problems in this area are considerably less prevalent in public works projects. As a general rule, problems in defining the scope of the work are inversely proportional to the contract amount on a private sector contract.

An equally important provision in the contract documents is the payment provision. Problems arise more often in the area of subcontractor vs. prime-contractor with regard to payment provisions. Frequently, the general contractor will attempt to make payment to the subcontractor conditional upon receipt of payment by the general contractor from the owner. It is perfectly proper for the contract to provide that the subcontractor will be paid upon receipt of payment by the general contractor from the owner. However, subtle changes in the wording of this paragraph can result in the subcontractor relying upon the credit of the owner rather than the credit of the prime contractor, which is a result seldom intended by the subcontractor or his surety. Terms such as "condition precedent" or like phraseology should be avoided whenever possible.[10]

The general contract and subcontract forms will traditionally contain an indemnity clause whereby the general contractor will hold the owner harmless or the subcontractor will hold the general contractor harmless from all liability, loss, cost, or damage arising out of the performance of the contract or subcontract. The promise traditionally extends to any damages for breach of contract, personal injury, or property damage. There have been many unsuccessful attempts to hold the surety liable for the negligence of the principal under the indemnity clauses. However, the surety has traditionally been successful in defending such actions, as it usually cannot be shown that there was a clear intention on the part of the surety to cover any personal injury or property damage claim.[11] For that reason, the bond underwriter can be relatively comfortable with the indemnity provision in the contract itself. However, any particular contract bond form sought to be used by the obligee should be examined in light of the previously expressed rule of the clear intention of the parties. That is to say, under no circumstances is it recommended that a bond be executed containing an indemnity provision. It may very well be that the surety would be providing coverage never intended for the premium charged.

All contract provisions are obviously important in assessing the surety's risk undertaking. The above provisions have been cited solely as a result of either the frequency of the occurrence of a dispute with regard to those provisions, or alternatively, as a result of the great potential exposure for the surety in the event that a provision is improperly worded or incorporated in the contractual agreement or bond. Most underwriters are aware that extreme caution should be taken in dealing with new or special bond forms prepared by some owners or government authorities. It is the apparent purpose of some of these new bond forms to transform the surety bond into a combination surety bond-indemnity contract, all risk coverage insurance policy. A new era of sophistication among potential obligees and bond claimants is rapidly approachin With that increased level of sophistication, the surety can expect that the evaluation and assessment of its risk will be more complicated, and potentially more risk-prone. The first, and foremost line of defense against the enhancemen of the surety's risk are the agents/underwriters in the field. It is only through their proper understanding and assessment of the entire surety undertaking from underwriting through claims that the profitability and viability of the surety program can be realized.

## FOOTNOTES

1. Uniform Commercial Code Article 9-203
2. Uniform Commercial Code Article 9-301
3. Uniform Commercial Code Articles 9-302,304,305
4. Uniform Commercial Code Article 9-105 (i)
5. Uniform Commercial Code Article 9-304 (5)
6. Uniform Commercial Code Article 9-402 (1)
7. Lambert v. Maryland Casualty Company, no. 196-638, 24th Judicial Dist Court, Parish of Jefferson, Louisiana
8. Vol. I, The Construction Lawyer, p. 8 (1980)
9. NAIC Proceedings - 1972, Vol. I, pp. 493-518
10. Thos. Dyer Co. v. Bishop International Engineering Company., 303F 2d 665 (6th Cir. 1962), also see Sasser Co. v. Griffin, 133 Ga. App. 83 (1974)
11. Tri-State Ins. Co. v. United States, 340F. 2d 542 (8th Cir. 1965)

The CHAIRMAN. The next witness will be Dr. John Magnotti, executive vice president, American Specialty Surety Council, accompanied by William Sommers, president, Surety Brokers of America; Mary Hunt, bond manager of The American Druggist Insurance Co.; Martin Cohen, president of the Exchange Mutual Insurance Co.; and, Vincent Galvin, attorney, Vincent Galvin and Associates, and Mountie Bedford, president, M. B. Underwriters.

Senator RUDMAN. Dr. Magnotti, thank you very much. We appreciate all of your being here today.

Your entire statement or statements will be incorporated into the record. However, in the interest of time, because of our scheduling today, why don't you proceed with a summary of your statement and comments that any of your panel might wish to offer before we ask any questions.

### STATEMENT OF DR. JOHN F. MAGNOTTI, JR., EXECUTIVE VICE PRESIDENT, AMERICAN SPECIAL SURETY COUNCIL, ACCOMPANIED BY WILLIAM SOMMERS, PRESIDENT, SURETY BROKERS OF AMERICA; MARY HUNT, BOND MANAGER, AMERICAN DRUGGISTS' INSURANCE CO.; MARTIN COHEN, PRESIDENT, EXCHANGE MUTUAL INSURANCE CO.; VINCENT GALVIN, CLAIMS ATTORNEY, VINCENT GALVIN AND ASSOCIATES; AND MOUNTIE BEDFORD, PRESIDENT, M B UNDERWRITERS

Dr. MAGNOTTI. Thank you, Mr. Chairman. Our statements will be short.

I want to introduce the people with me, and ask them to make statements.

My name, is John Magnotti. I am the executive vice president of the American Specialty Surety Council. TASSC is an association which unites specialty surety companies, their agents and that part of the legal community which supports specialty surety firms and agents. I have included a current membership roster with our statement for your information.

With me are Martin Cohen, the president of Exchange Mutual Insurance Co.; Mary Hunt, who is the bond manager for the American Druggists' Insurance Co.; William Sommers, the president of Surety Brokers of America, Inc., from Atlanta; Vincent Galvin, the president of Vincent Galvin and Associates, a surety attorney; and, Mountie Bedford, who just testified, is the president of M B Underwriters.

We requested that we be allowed to testify in these hearings for two reasons: First, the members of the association write more than 80 percent of the contract indemnity processed through the Small Business Administration's Surety Bond Guarantee program.

Because of this, and because many of our member companies have been involved in the program since its inception, we believe that we can provide the committee with a broadbased, accurate representation of actual program conditions.

Second, and in a sense a corollary of the first, there is little absolute uniformity among the companies operating in the program in their approach to underwriting and processing claims. There is a methodological spectrum in these two basic functional areas within the program.

It is our belief that the record of hearings should reflect the variations in approach to underwriting and claims processing, and the reasons that individual companies have adopted the operational procedures that they are now using.

With regard to the operation of the program by the SBA, we recognize that there are procedural and administrative problems. There are inconsistencies among the regions in the implementation of the program, as Mr. Bedford pointed out. There is a severe shortage of Government personnel in the program to handle claims, and the operational procedures adopted recently to implememt reductions in the surety bond guarantee budget may restrict program activities to the point where needy small contractors will not be able to find bonds of any kind and thus will not be able to work.

All of these shortcomings can be corrected. We believe emphatically that the Surety Bond Guarantee program is a good program. It provides the only source of bonding for thousands of small and minority contractors. It provides much needed jobs at local levels, and it is being run at relatively little actual cost to the Government.

With your permission now, Mr. Chairman, I would like to defer to Mr. Galvin for a very short statement, after which we will be pleased to answer questions from the committee.

Thank you.

Mr. GALVIN. Mr. Chairman, members of the committee, I might state at this point in time, that, although I practice in Boston, Mass., I am a constituent of Senator Rudman and live in New Hampshire, one of the escapees who went to the Great Granite State.

I'm going to deviate completely from the presentation that I have before you, gentlemen, because that tells pretty much what I have done for the past 20 years, representing surety companies and handling surety claims and lawsuits. I'm doing that because of what I've heard this morning. I want to clarify some definitions.

When you referred to claims, it would appear that you are referring to and thinking about the claims that go eventually to the SBA. I, as the attorney handling the claims in the field, think in terms of the claims against the bond, and I think in terms of how I handle those claims. It goes back 20 years, long before there was the SBA surety bond guarantee program; and I tell you, gentlemen, from the day I handled my first surety loss claim to the present time, I do not inquire and I do not give any consideration to whether or not the claim is indemnified or guaranteed by the Small Business Administration, or whether the indemnitors who have the original indemnification through the surety company are able to cover the loss.

I heard one of the prior witnesses talking about the standard company relying upon assets of the indemnitors of the principal when he starts out. Long before this program came into being, I was prosecuting and defending indemnification claims; and I frequently defend the claim and prosecute for indemnification at the same time. They go side by side, so that we see where the loss originates and whether the claim will be paid.

In some cases, even in the standard market, assets were not available to pay claims. That's one of the dangers of the business.

Another thing I'd like to point out is that you are going to have claims. This has occurred from the very beginning of suretyship, or at least from the time that the courts started to recognize the compensated surety. Before that, the surety was known as the darling of the law; now, he's damned by the law.

One of the problems I have in handling claims is that if I do not move fast, or if I do not make offers or if I resist too much, I get a consumers-type claim for three times the damages. I anticipate threats of that nature when I investigate a loss.

Consequently, sureties do have losses. The SBA is beginning to recognize this fact. We are in bad times, and losses seem to be exacerbated in bad times. I usually learn that I have an SBA-type guaranteed bond loss when I have the loss or the claim in front of me, and I reach out to find my principal to get the facts.

The established contractors, on the other hand, are more readily available. They might not tell you about the 40-foot cabin cruiser or the airplane; but at least they drive up in a Cadillac and tell you where the materials and people are.

With the people—many of the minorities and the small business people—I don't mean to use the word "minority" in a disparaging way—but I'm talking about the smaller contractors who are in the program being assisted by the SBA guarantee, and therefore being provided an opportunity. Many of those, when they run into the problem of claims—because of a necessity of having to support a family—drop the owner's hat, pick up the tools where they left off and go back as a foreman or a journeyman for somebody else. The result is that you do not have their assistance in handling the claims.

Therefore, many of these claims might cost more than they otherwise would in the case where you have a principal who can help you.

Finally, I'd like to talk about the generation of additional costs. I've heard you talking about how high they are, but one of the cases that immediately came to mind was one in the standard market with no SBA guarantee. When the general contractor, the principal under the bond, defaulted, the two subcontracts, one for the electrical work and one for plumbing, remained to be done. Each contract had a balance of $20,000.

However, the two subcontractors had the same attorney who is neither crooked nor mob-connected, but knowledgeable. He knew that under the law of Massachusetts, when a general contractor defaults, all subcontracts are terminated by law as a result of a Supreme Court decision. He, therefore, renegotiated to complete the job.

To bring in a completion contractor who would have to mobilize and buy the plumbing and light fixtures would cost $38,000 to $40,000 to do the original $20,000 job. The price quoted us to do the work was $38,000. We had to reach out to see if we could get somebody, and that was the price to finish the job.

I submit that that's not fraud; that's business. But that is the type of loss that we are confronted with. So when you see presumably inflated numbers, you should not assume fraud immediately.

Finally, I would like to comment on Senator Weicker's question, "What shall we do about this?" The attorneys that are handling the claims are held to a stricter course of conduct than you have even in the criminal side of court. The claims lawyer can be censured, can be disbarred, and can be put out of business quickly—not for being wrong or doing wrong and being found guilty of doing wrong, but just for being negligent and a bad lawyer.

On the other hand, where there is proof of fraud—for example, where a contractor bids on a job only to subcontract it to somebody else at a lower price and pocket the difference—I agree, any lawyer involved in something like that breaches the fiduciary relationship; and some action should be taken quickly. However, you don't have to destroy a whole program to take care of a bad egg.

Thank you, Mr. Chairman.

The CHAIRMAN. Senator Rudman?

Senator RUDMAN. Well, I just want to simply say that the purpose of this hearing, of course, is not to cripple the program. The purpose of the hearing is to try to make it a better program.

There's some history here. You were here during the testimony this morning, and I think, as taxpayers, you would all have to agree that some of those abuses ought to be stopped. That's the purpose of the hearing this morning.

Mr. GALVIN. I'm defending a suit right now in Vermont in which the bank, the obligee on the bond, turned around, because we denied—oh, I should state preliminarily that one of the witnesses this morning said: "There's never been a denial of claim." I've denied a claim of $420,000, and litigated that claim in the State of Vermont.

The obligee has turned around and brought suit for $6 million, trying to establish the fact that we're out paying the money—and this is an AFFI case, American Fidelity Fire—on the grounds that we're out to try to swindle the bank out of its just $420,000.

I petitioned AFFI to request SBA to become a party in that action so that the taxpayers and the 12 people on that jury, when this case gets tried, will know it's not AFFI's money; it's the taxpayers' money. I could not get the SBA to come in on that case, and when this case goes to trial in about 2 months, as the chairman points out, this is the taxpayers' money, but the 12 people on that jury aren't going to be able to know it's their money, and if a verdict comes in against us heavy, there's where we see these huge figures that you've been talking about earlier today.

A $450,000 penal sum bond is now in litigation for $6 million.

The CHAIRMAN. The testimony has shown that in a number of cases when there was a default, a completion contractor was selected who brokered out 100 percent of the work to another contractor. Now, do you do this and, if not, what do you think of the procedure?

Mr. GALVIN. Well, that is awful, what I heard you say. I'll tell you what a good surety lawyer does. A good surety lawyer, when he has to complete a project, first of all, reaches for the log of the original bidders. Why? Because they'd already have the plans, they'd already have the specs, they'd already know something about the job, and you wouldn't have to educate them. So you would go and invite them to participate, and you'll say, "The job is half done, a quarter done," or whatever it is. "Are you interested?" "Will you bid us?" "Will you come in and give us a bid, look the job over?"

Some of them might have taken other work some place else and they aren't interested. Sometimes you get some of the original bidders to come in and bid a price to you. Now, that price is going to be exacerbated because of the problems on the job and the stigma that goes with a job in default, but if you can't get one of those bidders, then you have to reach out for somebody else, and we do it all the time. But if you get somebody who comes in and gives you a price—first of all, we get an estimate of what it should cost from our owner and also from a consultant, and if we can get an estimate, and if we can get somebody to give a realistic bid, then we enter into a contract. If we cannot, then we tender settlement with the owner.

But to give a contract to somebody who then gives it to somebody else for half the price, now, that's out. If those are the facts, Senator, there's no question, that's wrongdoing of the first order, and we've got plenty of laws to take care of that.

The CHAIRMAN. Dr. Magnotti, I know that many times associations here in Washington are viewed as being here to lobby for their particular interests, and I don't see anything wrong with that, but it also seems to me that there are opportunities for these associations to perform a distinct service. Apparently there is a great lack of knowledge and/or expertise over at SBA that's creating problems in this program, both from the point of view of expenditures of money, insofar as the Government is concerned, and probably also insofar as the dealings between the Government and the people that you represent.

It seems to me that some sort of a task force by your association that would offer advice in these areas would be very welcomed over at SBA.

Dr. **Magnotti**. As a matter of fact, we have offered that many times, Mr. Chairman. We have been in close contact with the SBA. We have offered them advice. We have commented on every one of the memorandums that have come out on that program. Internally, within the association, we have developed underwriting claims committees to increase and enhance the efficiency with which those functions are done.

We have also offered at any time to be available to the SBA to answer questions dealing with the specialties. We would be pleased to be involved in any consulting effort that you would want to undertake that would deal with a reorganization of that program. We are for that 100 percent.

The **Chairman**. Because, again, of the time constraints upon us, and the fact that we still have one more witness to hear from, I will have some questions to submit to you for response to the record, and at this time, the witnesses are excused.

Dr. **Magnotti**. We would be delighted to answer those. Thank you very much for having us.

The **Chairman**. Thank you very much.

[The prepared statements of Dr. Magnotti and Mr. Galvin follow:]

TASSC

THE AMERICAN
SPECIALTY SURETY COUNCIL

1001 North Highland Street, Suite 101, Arlington, Virginia 22201 • 703 / 528-0072

STATEMENT BY
DR. JOHN F. MAGNOTTI JR.
EXECUTIVE VICE PRESIDENT
THE AMERICAN SPECIALTY SURETY COUNCIL

BEFORE THE
SENATE SMALL BUSINESS COMMITTEE

MARCH 11, 1982

MR. CHAIRMAN, MY NAME IS JOHN MAGNOTTI, AND I AM THE EXECUTIVE VICE PRESIDENT OF THE AMERICAN SPECIALTY SURETY COUNCIL. TASSC IS AN ASSOCIATION WHICH UNITES SPECIALTY SURETY COMPANIES, THEIR AGENTS AND THAT PART OF THE LEGAL COMMUNITY WHICH SUPPORTS SPECIALTY SURETY FIRMS AND AGENTS. I HAVE INCLUDED A CURRENT MEMBERSHIP ROSTER.

WITH ME ARE MARTIN COHEN, PRESIDENT OF EXCHANGE MUTUAL INSURANCE COMPANY; MARY HUNT, BOND MANAGER FOR THE AMERICAN DRUGGISTS' INSURANCE COMPANY; WILLIAM SOMMERS, PRESIDENT OF SURETY BROKERS OF AMERICA, INC.; VINCENT GALVIN, PRESIDENT OF VINCENT GALVIN AND ASSOCIATES; AND MOUNTIE BEDFORD, PRESIDENT OF MB UNDERWRITERS.

THE ASSOCIATION REQUESTED THAT WE BE ALLOWED TO TESTIFY IN THESE HEARINGS FOR TWO REASONS. FIRST, THE MEMBERS OF THIS ASSOCIATION WRITE MORE THAN 80 PERCENT OF THE CONTRACT IDEMNITY PROCESSED THROUGH THE SMALL BUSINESS ADMINISTRATION'S SURETY BOND GUARANTEE PROGRAM. BECAUSE OF THIS, AND BECAUSE MANY OF OUR MEMBER COMPANIES HAVE BEEN INVOLVED IN THE PROGRAM SINCE ITS INCEPTION, WE BELIEVE THAT WE CAN PROVIDE THE COMMITTEE WITH A BROAD-BASED, ACCURATE REPRESENTATION OF ACTUAL PROGRAM CONDITIONS. SECOND, AND IN A SENSE A COROLLARY OF THE FIRST, THERE IS LITTLE ABSOLUTE UNIFORMITY AMONG THE COMPANIES OPERATING IN THE PROGRAM IN THEIR APPROACH TO UNDERWRITING AND PROCESSING CLAIMS. THERE IS A METHODOLOGICAL SPECTRUM IN THESE TWO BASIC FUNCTIONAL AREAS WITHIN THE PROGRAM. IT IS OUR BELIEF THAT THE RECORD OF

THESE HEARINGS SHOULD REFLECT THE VARIATIONS IN APPROACH TO UNDERWRITING AND CLAIMS PROCESSING AND THE REASONS THAT INDIVIDUAL COMPANIES HAVE ADOPTED THE OPERATIONAL PROCEDURES THEY ARE NOW USING.

THE SYSTEMS USED BY INDIVIDUAL COMPANIES FOR UNDERWRITING AND CLAIMS PROCESSING ARE BOTH OPERATIONALLY AND COST EFFECTIVE AND REFLECT RATIONAL BUSINESS DECISIONS MADE ON THE BASIS OF COMPANY SIZE, FINANCIAL CONDITION AND OVERALL MARKETS. THIS LATTER REASON IS PARTICULARLY IMPORTANT SINCE SOME OF OUR MEMBER COMPANIES PARTICIPATE IN BOTH STANDARD AND SPECIALTY SURETY MARKETS.

WITH REGARD TO THE OPERATION OF THE PROGRAM BY SBA, WE RECOGNIZE THAT THERE ARE PROCEDURAL AND ADMINISTRATIVE PROBLEMS. THERE ARE INCONSISTENCIES AMONG THE REGIONS IN THE IMPLEMENTATION OF THE PROGRAM; THERE IS A SEVERE SHORTAGE OF GOVERNMENT PERSONNEL IN THE PROGRAM TO HANDLE CLAIMS; AND THE OPERATIONAL PROCEDURES ADOPTED RECENTLY TO IMPLEMENT REDUCTIONS IN THE SURETY BOND GUARANTEE BUDGET MAY RESTRICT PROGRAM ACTIVITIES TO THE POINT WHERE NEEDY SMALL CONTRACTORS WILL NOT BE ABLE TO FIND BONDS OF ANY KIND AND THUS WILL NOT BE ABLE TO WORK.

ALL OF THESE SHORTCOMINGS CAN BE CORRECTED. WE BELIEVE EMPHATICALLY THAT THE SURETY BOND GUARANTEE PROGRAM IS A GOOD PROGRAM. IT PROVIDES THE ONLY SOURCE OF BONDING FOR THOUSANDS OF SMALL AND MINORITY CONTRACTORS. IT PROVIDES MUCH NEEDED JOBS AT LOCAL LEVELS, AND IT IS BEING RUN AT RELATIVELY LITTLE ACTUAL COST TO THE GOVERNMENT.

WITH YOUR PERMISSION, MR. CHAIRMAN, I WOULD LIKE TO DEFER TO MR. GALVIN AND MR. BEDFORD, BOTH OF WHOM WILL MAKE SHORT STATEMENTS, AFTER WHICH WE WILL BE PLEASED TO ANSWER QUESTIONS FROM THE COMMITTEE.

THANK YOU.

TASSC

THE AMERICAN
SPECIALTY SURETY COUNCIL

1001 North Highland Street, Suite 101, Arlington, Virginia 22201 • 703 / 528-0072

## MEMBERSHIP REPORT

## SUMMARY

## MARCH 1, 1982

| Membership Classification | Number of Members |
|---|---|
| Specialty Surety Firms | Twelve |
| Managing General Agents | Seven |
| General Agents | Forty-One |
| Attorneys | Eighty |
| Consultants | Two |

**TOTAL MEMBERSHIP: ONE HUNDRED FORTY-TWO**

# ALPHABETICAL INDEX OF MEMBER FIRMS

| | Page |
|---|---|
| **SPECIALTY SURETY FIRMS** | |
| American Fidelity Fire Insurance Company | 2 |
| Balboa Insurance Company | 2 |
| Dependable Insurance Company | 9 |
| Exchange Mutual Insurance Company | 11 |
| Heritage Insurance Company of America | 14 |
| Integon Indemnity Corporation | 16 |
| Integrity Insurance Company | 16 |
| International Fidelity Insurance Company | 16 |
| Morrison Assurance Company, Inc. | 23 |
| National Bonding and Accident Insurance Company | 23 |
| Prestige Casualty Company | 26 |
| The American Druggists' Insurance Company | 32 |
| **MANAGING GENERAL AGENTS** | |
| Bonds II of America, Inc. | 4 |
| Market Insurance Corporation | 21 |
| Midwest Indemnity Corporation | 22 |
| Skinner Bonding and Ins. | 29 |
| Surety Brokers of America, Inc. | 31 |
| Texas Surety Agency | 31 |
| Wright General Agency | 36 |

## GENERAL AGENTS

| | Page |
|---|---|
| Alabama Surety Brokers, Inc. | 1 |
| Allen-Smith Ins., Inc. | 1 |
| Avenue Ins. Agency, Inc. | 2 |
| Beeson and Co., Inc. | 3 |
| Boley-Featherston-Huffman and Deal | 3 |
| Bolton and Co. | 3 |
| Bond Market Corporation | 4 |
| Byerly Ins. Agency and Brokers, Inc. | 4 |
| Construction Bond and Ins. Services, Inc. | 6 |
| Contractors Bonds, Inc. | 7 |
| Cornish-Mowers Agency, Inc. | 7 |
| Data and Staff Service Co. | 8 |
| David E. Flatow and Co. | 8 |
| Del Nido and Asociados, Inc. | 8 |
| Edmund J. Boyce, Inc. | 10 |
| Fleetwood Agency, Inc. | 12 |
| Hallmark Underwriters, Inc. | 14 |
| Haynes Brinkley and Co. | 14 |
| Huckleberry, Sibley and Harvey Ins. and Bonds, Inc. | 15 |
| Ins. and Bonding Mart, Inc. | 15 |
| John Morris, Inc. | 17 |
| Leavitt Ins. Agency | 19 |
| Lou Jones Associates | 20 |
| Manuel Lujan Insurance Inc. | 21 |

| | Page |
|---|---|
| Midwest Surety Services, Inc. | 23 |
| Oklahoma General Agency | 24 |
| Patterson & Associates Inc. | 25 |
| Patterson, Wylde and Windeler, Inc. | 25 |
| Progressive Ins. Agency, Inc. | 26 |
| RMBC | 27 |
| Romine & Associates, Inc. | 27 |
| Smith-Manus Agency | 29 |
| Surety and Special Mkt Underwriters, Inc. | 30 |
| Surety Bond Underwriters, Inc. | 30 |
| Surety Market Agency, Inc. | 31 |
| Surety Underwriters Service Co. | 31 |
| The Fairfield Co. | 32 |
| Underwriter's Service Co. | 33 |
| Unified Services, Inc. | 33 |
| Union Life and Casualty Ins. Agencies | 33 |
| Viceroy Management, Inc. | 34 |

**CONSULTANTS**

| | |
|---|---|
| Construction Management Associates, Inc. | 7 |
| John P. Grimes, Consultant | 7 |

**ATTORNEYS**

| | Page |
|---|---|
| Achilles and Cammack | 1 |
| Adams and Philipps | 1 |
| Attorney at Law , Robert Huie | 2 |
| Barry Bernstein and Associates | 3 |
| Brimit and Witt | 4 |
| Carey, Dwyer, Cole, Selwood and Bernard | 5 |
| Carroll S. Barco | 5 |
| Case and Dusterhoff | 5 |
| Chappell, Brandt and Gore | 5 |
| Cheek, Cheek & Cheek | 6 |
| Civerolo, Hansen and Wolf | 6 |
| Cohen and Annand, PC | 6 |
| Denney, Morgan & Rather | 8 |
| DeWitte Thompson, PC | 9 |
| Donohue-Reynolds | 9 |
| Doug Wood and Associates, Ltd. | 9 |
| Edwards, Hunt, Pearson and Hale, Ltd. | 10 |
| Eisenhower and Carlson | 10 |
| Evans & Dixon | 10 |
| Evans, Grebe, Gross, Jensen & Peek | 11 |
| Fairley, Hamrick, Monteith & Cobb | 11 |
| Fitzgibbons & Beatty | 11 |
| Frank and Stefani | 12 |
| Franklin, Moore & Walsh | 12 |

| | Page |
|---|---|
| Frost and Jacobs | 12 |
| Gerson, Steiner & Anderson | 13 |
| Gilmartin, Hallenbeck and Schroeder, Ltd. | 13 |
| Godfrey, Pfeil and Neshek, SC | 13 |
| Goushian, Mooradian & Goldsmith, PC | 13 |
| Harold B. Green | 14 |
| Hofing and Buckley | 15 |
| Husch, Eppenberger, Donohue, Elson and Cornfeld | 15 |
| Jenkins & Fenstermaker, Krieger, Kayes & Farrell | 16 |
| Jennings, Strouss & Salmon | 17 |
| Kavaney and Wilcox | 17 |
| Kimmelman, Wolff and Samson | 17 |
| Lane, Powell, Moss and Miller | 18 |
| Lang, Pauly and Gregerson, Ltd | 18 |
| Law Offices of J. Michael Pisias, Jr. | 18 |
| Lawrence, Griffin and Dick | 18 |
| Leritz and Reinert, PC | 19 |
| Leshman, Knoll & Reifman | 19 |
| Less and Scroggs | 19 |
| Linder and Taylor | 20 |
| Loomis, Lazear, Wilson & Pickett | 20 |
| Looney, Nichols, Johnson and Hayes | 20 |
| Manier, White, Herod, Hollabaugh and Smith | 21 |
| Margolin and Kirwan | 21 |
| Marola, Bohren and Gronowski | 22 |

Page

McNamara and McNamara 22
Michael E. McNichols, Lawyer 22
Newman and Schlau, PC 23
Norling, Rolle, Oeser and Williams 24
Ott and Purdy 24
Palmer, Howard and Nowak 24
Patten, Brown and Leslie 25
Phillips, Hart & Mozley 25
Plowman and Spiegel 26
Pretzel, Stouffer, Nolan and Rooney 26
Richardson, Groseclose, Kornmann, Wyly, Wise & Klinkel 27
Sadur and Pelland 27
Schabe, Williamson, Wyatt, Moore and Roberts 28
Shell, Buford, Bufkin, Callicut and Perry 28
Sills, Beck, Cummis, Radin and Tischman, PA 28
Simon, Peragine, Smith and Redfearn 28
Skelley, Vinkels, Williams and Rottner, PC 29
Snow, Christensen and Martineau 29
Steptoe and Johnson 30
Stockwell, Sievert, Viccellio, Clements and Shaddock 30
Tilly and Graves 32
Ulvin and Sullivan 32
United Inspection Bureau, Inc. 33
Venzie, Phillips and Warshawer 34
Vincent Galvin and Associates 34
Weckworth, Barer & Meyers 34
Welbaum, Zook, Jones and Williams 35
Weller, Friedrich, Hickisch and Hazlitt 35
Welsch, Flatness & Lutz, Inc. 35
Winstead, McGuire, Sechrest and Minick 35
Wright, Lindsey and Jennings 36

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711 Land Title Bldg, Broad and Chestnut Sts
Philadelphia, PA 19110

Telephone: 215/567-4737

Firm Representative(s): M. George Mooradian

Membership Classification: AT

Hallmark Underwriters, Inc.
755 W Big Beaver Rd, #1125
Troy, MI 48084

Telephone: 313/362-1012

Firm Representative(s): Sanford Wolok

Membership Classification: GA

Harold B. Green
3701 Wilshire Blvd
Los Angeles, CA 99010

Telephone: 213/380-8992

Firm Representative(s): Harold Green

Membership Classification: AT

Haynes Brinkley and Co.
P.O. Drawer 10027
Jackson, MS 39206

Telephone: 601/981-3240

Firm Representative(s): Haynes Brinkley Jr.

Membership Classification: GA

Heritage Insurance Company of America
7633 North Lincoln Avenue
Lincolnwood, IL 60646

Telephone: 312/982-9800

Firm Representative(s): Martin Shape

Membership Classification: F

Hofing and Buckley
928 West State Street
Trenton, NJ 08618

Telephone: 609/392-6131

Firm Representative(s): Sidney Hofing

Membership Classification: AT

Huckleberry, Sibley and Harvey Ins. and Bonds, Inc.
1901 Lee Road
Winter Park, FL 32789

Telephone: 305/647-1616

Firm Representative(s): Joe Huckleberry

Membership Classification: GA

Husch, Eppenberger, Donohue, Elson and Cornfeld
100 N Broadway
St. Louis, MO 63102

Telephone: 314/421-4800

Firm Representative(s): Terry Sale

Membership Classification: AT

Ins. and Bonding Mart, Inc.
Box 54594
Atlanta, GA 30379

Telephone: 404/633-9331

Firm Representative(s): Michael Brewer

Membership Classification: GA

Integon Indemnity Corporation
500 W 5th St, Box 3199
Winston Salem, NC 27102

Telephone: 919/725-7261

Firm Representative(s): John Johnson.

Membership Classification: F

Integrity Insurance Company
One Mark Center Drive
Paramus, NJ 07652

Telephone: 201/262-9300

Firm Representative(s): Lawrence Stern, Gene McGee

Membership Classification: F

International Fidelity Insurance Company
24 Commerce St
Newark, NJ 07102

Telephone: 201/624-7200

Firm Representative(s): Francis Mitterhoff

Membership Classification: F

Jenkins & Fenstermaker, Krieger, Kayes & Farrell
Box 2688
Huntington, WV 25726

Telephone: 304/697-2100

Firm Representative(s): John Jenkins Jr.

Membership Classification: AT

Jennings, Strouss & Salmon
111 West Monroe Street
Phoenix, AZ 85003

Telephone: 602/262-5817

Firm Representative(s): Patrick Flood

Membership Classification: AT

John Morris, Inc.
Box 1928
San Juan, PR 00936

Telephone: 809/754-0008

Firm Representative(s): John Morris Jr.

Membership Classification: GA

Kavaney and Wilcox
1220 Northern Federal Bldg
St. Paul, MN 55102

Telephone: 612/227-7551

Firm Representative(s): Pat Wilcox

Membership Classification: AT

Kimmelman, Wolff and Samson
80 Main Street
West Orange, NJ 07052

Telephone: 201/325-2700

Firm Representative(s): David Samson

Membership Classification: AT

Lane, Powell, Moss and Miller
3800 Ranier Bank Tower
Seattle, WA 08101

Telephone: 206/223-7000

Firm Representative(s): Arthur Harrigan Jr.

Membership Classification: AT

Lang, Pauly and Gregerson, Ltd
4108 IDS Center
Minneapolis, MN 55402

Telephone: 612/338-0755

Firm Representative(s): David Gregerson

Membership Classification: AT

Law Offices of J. Michael Pisias, Jr.
177 Post Street, Suite 700
San Francisco, CA 94108

Telephone: 415/433-3993

Firm Representative(s): J. Michael Pisias Jr.

Membership Classification: AT

Lawrence, Griffin and Dick
765 CNA Tower, 255 S. Orange Avenue, Box 3427
Orlando, FL 32802

Telephone: 305/425-2518

Firm Representative(s): Harry Lawrence

Membership Classification: AT

Leavitt Ins. Agency
823 S 6th St, Box 15350
Las Vegas, NV 89114

Telephone: 702/382-4010

Firm Representative(s): Bert Leavitt

Membership Classification: GA

Leritz and Reinert, PC
314 North Broadway, Suite 843
St. Louis, MO 63102

Telephone: 314/621-5743

Firm Representative(s): Bernard Reinert

Membership Classification: AT

Leshman, Knoll & Reifman
24700 Northwestern Highway
Southfield, MI 48075

Telephone: 313/357-4340

Firm Representative(s): Richard Knoll

Membership Classification: AT

Less and Scroggs
100 N Main Bldg, #1002
Memphis, TN 38103

Telephone: 901/274-8700

Firm Representative(s): Michael Less

Membership Classification: AT

Linder and Taylor
One Indiana Sq., Ste 3170
Indianapolis, IN 46204

Telephone: 317/637-3170

Firm Representative(s): Charles Linder

Membership Classification: AT

Loomis, Lazear, Wilson & Pickett
202 East 18th Street, Box 408
Cheyenne, WY 82001

Telephone: 632-5596

Firm Representative(s): Henry Bailey Jr.

Membership Classification: AT

Looney, Nichols, Johnson and Hayes
219 Couch Drive
Oklahoma City, OK 73102

Telephone: 405/235-7641

Firm Representative(s): John Hayes

Membership Classification: AT

Lou Jones Associates
2900 West Broadway
Los Angeles, CA 90041

Telephone: 213/257-8291

Firm Representative(s): Lou Jones

Membership Classification: GA

Manier, White, Herod, Hollabaugh and Smith
700 Home Federal Tower
Nashville, TN 37219

Telephone: 615/244-0030

Firm Representative(s): Michael Franks

Membership Classification: AT

Manuel Lujan Insurance Inc.
2001 San Mateo NE
Albuquerque, NM 87110

Telephone: 505/266-7771

Firm Representative(s): Edward Lujan

Membership Classification: GA

Margolin and Kirwan
1000 United Missouri Bank Bldg
Kansas City, MO 64106-2051

Telephone: 816/842-7080

Firm Representative(s): F. Philip Kirwan

Membership Classification: AT

Market Insurance Corporation
15910 Ventura Blvd
Encino, CA 91436

Telephone: 213/788-9424

Firm Representative(s): Arthur Bernstein

Membership Classification: MGA

Marola, Bohren and Gronowski
10401 W Lincoln Ave, #203
Milwaukee, WI 53227

Telephone: 414/327-5800

Firm Representative(s): Joseph Gronowski

Membership Classification: AT

McNamara and McNamara
88 East Broad Street, Suite 1250
Columbus, OH 43215

Telephone: 614/228-6131

Firm Representative(s): Dennis Liston

Membership Classification: AT

Michael E. McNichols, Lawyer
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Telephone: 208/476-5734

Firm Representative(s): Michael McNichols

Membership Classification: AT

Midwest Indemnity Corporation
7366 North Lincoln Ave
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Telephone: 312/982-9800

Firm Representative(s): Marvin Mann

Membership Classification: MGA

Midwest Surety Services, Inc.
1305 N Barker Rd
Brookfield, WI 53005

Telephone: 414/784-8130

Firm Representative(s): Joseph Vigna

Membership Classification: GA

Morrison Assurance Company, Inc.
Box 160387
Mobile, AL 36625

Telephone: 205/344-3000

Firm Representative(s): William Walsh

Membership Classification: F

National Bonding and Accident Insurance Company
4242 Lindell Blvd
St. Louis, MO 63108

Telephone: 314/534-5545

Firm Representative(s): John Delaloye

Membership Classification: F

Newman and Schlau, PC
17 Battery Place
New York, NY 10004

Telephone: 212/425-1990

Firm Representative(s): Richard Newman, Philip Schlau

Membership Classification: AT

Norling, Rolle, Oeser and Williams
2701 E Camelback, Suite 100
Phoenix, AZ 85016

Telephone: 602/955-5940

Firm Representative(s): James Rolle III

Membership Classification: AT

Oklahoma General Agency
809 Northwest 36th
Oklahoma City, OK 73118

Telephone: 405/525-8181

Firm Representative(s): Marie Welch

Membership Classification: GA

Ott and Purdy
Box 361
Jackson, MS 39205

Telephone: 601/969-4140

Firm Representative(s): Luther Ott, Bill Purdy

Membership Classification: AT

Palmer, Howard and Nowak
4030 B Lucille Ave
Lithia Springs, GA 30057

Telephone: 404/944-9444

Firm Representative(s): Larry Palmer

Membership Classification: AT

Patten, Brown and Leslie
1095 Union National Plaza
Little Rock, AR 72201

Telephone: 501/374-7582

Firm Representative(s): Robert Leslie

Membership Classification: AT

Patterson & Associates Inc.
4740 Chevy Chase Drive
Chevy Chase, MD 20815-6499

Telephone: 301/654-6850

Firm Representative(s): Irma Lucca

Membership Classification: GA

Patterson, Wylde and Windeler, Inc.
One Washington Mall
Boston, MA 02108

Telephone: 617/482-7750

Firm Representative(s): Chester Conary

Membership Classification: GA

Phillips, Hart & Mozley
233 Peachtree St, NE, Suite 1200
Atlanta, GA 30303

Telephone: 404/522-2010

Firm Representative(s): Albert Phillips, George C. Reid

Membership Classification: AT

Plowman and Spiegel
3400 Grant Building
Pittsburgh, PA 15219

Telephone: 412/471-8521

Firm Representative(s): John Spiegel

Membership Classification: AT

Prestige Casualty Company
5454 Fargo Avenue
Skokie, IL 60077

Telephone: 312/583-4444

Firm Representative(s): Marvin Himmelstein

Membership Classification: F

Pretzel, Stouffer, Nolan and Rooney
Two North LaSalle St, Suite 1700
Chicago, IL 60602

Telephone: 312/346-1973

Firm Representative(s): Richard Wisner

Membership Classification: AT

Progressive Ins. Agency, Inc.
1220 S Broadway
Lexington, KY 40504

Telephone: 606/253-1561

Firm Representative(s): Russell Davis

Membership Classification: GA

Richardson, Groseclose, Kornmann, Wyly, Wise & Klinkel
Box 489
Aberdeen, SD 57401

Telephone: 605/225-6311

Firm Representative(s): James Wyly

Membership Classification: AT

RMBC
910 - 15th St, #668
Denver, CO 80202

Telephone: 303/623-6931

Firm Representative(s): James Misken

Membership Classification: GA

Romine & Associates, Inc.
2606 Corporate Avenue East, Suite 224
Memphis, TN 38132

Telephone: 901/332-7725

Firm Representative(s): Claude Romine

Membership Classification: GA

Sadur and Pelland
2000 L Street, N, #612
Washington, DC 20036-4993

Telephone: 202/872-8383

Firm Representative(s): Marvin Sadur, Francis Pelland

Membership Classification: AT

Schabe, Williamson, Wyatt, Moore and Roberts
1100 SW Sixth, #1200, Standard Plaza Building
Portland, OR 97204

Telephone: 503/222-9981

Firm Representative(s): Jim Huegli

Membership Classification: AT

Shell, Buford, Bufkin, Callicut and Perry
Box 157
Jackson, MS 39205

Telephone: 601/948-2291

Firm Representative(s): Kenneth Perry

Membership Classification: AT

Sills, Beck, Cummis, Radin and Tischman, PA
33 Washington Street
Newark, NJ 07102

Telephone: 201/643-3232

Firm Representative(s): Steven Radin

Membership Classification: AT

Simon, Peragine, Smith and Redfearn
4300 One Shell Square
New Orleans, LA 70319

Telephone: 504/522-3030

Firm Representative(s): Bruce Shreves

Membership Classification: AT

Skelley, Vinkels, Williams and Rottner, PC
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Hartford, CT 06106

Telephone: 203/246-6891

Firm Representative(s): Jeffrey Williams

Membership Classification: AT

Skinner Bonding and Ins.
181 Fremont St, #120
San Francisco, CA 94105

Telephone: 415/495-3181

Firm Representative(s): Robert Skinner

Membership Classification: MGA

Smith-Manus Agency
Box 118
Louisville, KY 40201

Telephone: 502/636-9191

Firm Representative(s): J. T. Smith, John Smith

Membership Classification: GA

Snow, Christensen and Martineau
10 Exchange Place, 11th Flr, Box 3000
Salt Lake City, UT 81110

Telephone: 801/521-9000

Firm Representative(s): A. Dennis Norton

Membership Classification: AT

Steptoe and Johnson
1250 Connecticut Avenue, NW
Washington, DC 20036

Telephone: 202/862-2372

Firm Representative(s): Joseph Nealon

Membership Classification: AT

Stockwell, Sievert, Viccellio, Clements and Shaddock
Box 2900
Lake Charles, LA 70602

Telephone: 318/436-9491

Firm Representative(s): Emmett Sole

Membership Classification: AT

Surety and Special Mkt Underwriters, Inc.
4545 Downman Rd
New Orleans, LA 70126

Telephone: 504/245-0453

Firm Representative(s): A. J. Pilet

Membership Classification: GA

Surety Bond Underwriters, Inc.
212 Carroll Bldg, 8600 LaSalle Rd
Baltimore, MD 21204

Telephone: 301/821-7430

Firm Representative(s): Terry Kravetz

Membership Classification: GA

Surety Brokers of America, Inc.
Post Office Drawer 49407
Atlanta, GA 30359

Telephone: 404/325-2731

Firm Representative(s): Hugh Norton

Membership Classification: MGA

Surety Market Agency, Inc.
2436 Central Parkway
Cincinnati, OH 45214

Telephone: 513/621-5252

Firm Representative(s): Frank Lech

Membership Classification: GA

Surety Underwriters Service Co.
1200 2nd Ave S
Minneapolis, MN 55403

Telephone: 612/339-6893

Firm Representative(s): George Hock

Membership Classification: GA

Texas Surety Agency
Box 9008
Fort Worth, TX 76107

Telephone: 817/332-1844

Firm Representative(s): Gary DeHart

Membership Classification: MGA

The American Druggists' Insurance Company
30 E Central Parkway
Cincinnati, OH 45202

Telephone: 513/721-4270

Firm Representative(s): Mary Hunt

Membership Classification: F

The Fairfield Co.
1200 2nd Ave, S
Minneapolis, MN 55403

Telephone: 612/339-6891

Firm Representative(s): Tom Fairfield

Membership Classification: GA

Tilly and Graves
50 South Steele Street, Suite 800
Denver, CO 80209

Telephone: 303/321-8811

Firm Representative(s): L. Jay Labe

Membership Classification: AT

Ulvin and Sullivan
871 White Bear Avenue
St. Paul, MN 55106

Telephone: 612/778-1204

Firm Representative(s): Jerrold Sullivan

Membership Classification: AT

Underwriter's Service Co.
3347 Highway 5
Douglasville, GA 30135

Telephone: 404/949-7100

Firm Representative(s): Dan Love

Membership Classification: GA

Unified Services, Inc.
P.O. Drawer 15430
GMF, Little Rock, AR 72231-5430

Telephone: 501/758-7807

Firm Representative(s): Mike Babb

Membership Classification: GA

Union Life and Casualty Ins. Agencies
4810 N Black Canyon
Phoenix, AZ 85017

Telephone: 602/249-1020

Firm Representative(s): Jon Walker

Membership Classification: GA

United Inspection Bureau, Inc.
15910 Ventura Blvd, 14th Fl
Encino, CA 91436

Telephone: 213/788-9420

Firm Representative(s): Perry Lisker

Membership Classification: AT

**Venzie, Phillips and Warshawer**
2032 Chancellor Street
Philadelphia, PA 19103

Telephone: 215/567-3322

Firm Representative(s): Bruce Phillips

Membership Classification: AT

Viceroy Management, Inc.
7366 North Lincoln Avenue
Lincolnwood, IL 60646

Telephone: 312/677-1812

Firm Representative(s): George Thomas

Membership Classification: GA

Vincent Galvin and Associates
40 Broad St
Boston, MA 02109

Telephone: 617/357-9640

Firm Representative(s): Vincent Galvin

Membership Classification: AT

Weckworth, Barer & Meyers
925 Denny Building
Seattle, WA 98121

Telephone: 206/624-6795

Firm Representative(s): W. T. Weckworth

Membership Classification: AT

Welbaum, Zook, Jones and Williams
Box 3626
Orlando, FL 32802

Telephone: 305/423-5595

Firm Representative(s): Lloyd Zook

Membership Classification: AT

Weller, Friedrich, Hickisch and Hazlitt
900 Capitol Life Center
Denver, CO 80203

Telephone: 303/861-8000

Firm Representative(s): David Kerr

Membership Classification: AT

Welsch, Flatness & Lutz, Inc.
1139 Olive Street, Drawer 14
St. Louis, MO 63101

Telephone: 314/241-7811

Firm Representative(s): Thomas Welsch

Membership Classification: AT

Winstead, McGuire, Sechrest and Minick
1700 Mercantile Dallas Bldg
Dallas, TX 75201

Telephone: 214/742-1700

Firm Representative(s): Steven Nelson

Membership Classification: AT

Wright General Agency
Box 598
Bunkie, LA 71322

Telephone: 318/346-2065

Firm Representative(s): R. L. Wright, Sr.

Membership Classification: MGA

Wright, Lindsey and Jennings
2200 Worthen Bank Building
Little Rock, AR 72201

Telephone: 501/371-0808

Firm Representative(s): Ronald May

Membership Classification: AT

TESTIMONY OF
VINCENT GALVIN
ATTORNEY AT LAW
40 BROAD STREET
BOSTON, MASSACHUSETTS 02109

FOR HEARINGS SCHEDULED ON
MARCH 11, 1982

Mr. Chairman,

My name is Vincent Galvin. I am an attorney with offices in Boston, Massachusetts, conducting my profession under the title of Vincent Galvin & Associates. I have four associates, and together we cover the entire New England states on surety matters.

I might add at this point, Mr. Chairman, presently my office is handling at least six surety losses in your state of Connecticut, all of which bonds were written under the Small Business Administration's Surety Bond Guarantee program.

I have been specializing in surety defense work for various surety companys for the past twenty years. During that time I have represented over twelve surety companys directly, investigating surety claims, settling losses experienced by the surety companys, and arranging for and supervising the completion of the projects for the surety companys involved. In this activity I have caused the completion of projects ranging from railroad track construction to earth dams to high-rise apartments and garden-type apartment complexes including complex mechanical bulk mail handling installations and sophisticated navigational aids for both the United States Coast Guard and the Federal Aviation Administration.

My experience is that when an attorney knowledgeable in construction customs and procedures and well versed in surety law is introduced to the apparent problem at the early stages of a controversy, the results are:

1. Matters in dispute are quickly identified.
2. Personality clashes are promptly recognized and terminated by the interaction of a professional third party with experience in dispute settling techniques.
3. In many cases the dispute is resolved without the

surety company experiencing a loss payment.

4. In those cases where it is apparent that the contractor is in default or is not capable of finishing the project without the intervention of surety, the attorney knows how to move swiftly to:

    a. Keep progress on the job by either temporarily financing the contractor or obtaining the necessary forces to keep that particular portion of the total construction project progressing so as not to disturb other related activities, or,

    b. Obtain the prospective completing contractors from the original bidders, or,

    c. Draw the necessary documentation to relet the job for completion contractors' bids, after obtaining a realistic estimate of cost to complete.

5. While the attorney is directing his attention to the probable loss, at the same time he is directing his efforts to recover most if not all of that loss from the indemnitors by prompt and proper notice to

all of the indemnitors followed by action against the collateral security.

The result is that although it might appear on the surface that the surety is using expensive professional talent to do investigative work, the fact is that the surety is minimizing its costs and expenses by avoiding losses where it is possible and minimizing those losses where they are inevitable.

In those cases where the surety uses an adjuster or some investigative service, it is spending money to obtain facts with no chance towards solving the problems that those facts are disclosing. When those facts are assembled by the mere investigative arm, they then have to be analyzed by the company to determine what, if any, action should be taken. If it is merely a conflict of personalities, the investigator can do no more than report same to the company; whereas the attorney would use his professional expertise immediately to resolve the matter.

On the other hand, if the investigative inquirer ascertains that it is in fact a bona fide loss situation that he is observing, he can do no more than to report the same to the company, which then must bring in the attorney. The attorney must then cover the same ground that the investigator has reported on. Frequently, this lost time has already resulted in an exacerbation of a loss situation by disruption of construction scheduling . The attorney must then recommend to the company the possible courses of action that are to be taken to minimize the loss and to effect indemnification. But, by that time, the options available to the company have been greatly diminished by the intervention of the psychological factors of a project in trouble. The result in such a situation often means that bidding contractors for completion are anticipating a deteriorating situation and their charges for completion reflect an allowance for anticipated future problems with the result that the cost of completion is greatly inflated.

In summary, let me state that a knowledgeable surety attorney with experience in the handling of surety losses or claims called in by the surety company upon the first alert results in problems being resolved before they become actual claims against the bond or substantially minimizes the loss in those cases where the claim inevitably matures into a loss situation either by the requirement of payment of claims of material suppliers or subcontractors or in the cost of completion of a project. The use of purely investigative services in the initial handling of any first alerts produces only an expense item for the gathering of information and does not either by design or purpose resolve a problem or dispose of a claim. The use of attorneys for this activity should surely be encouraged if not in fact mandated.

Thank you very much.

TASSC

THE AMERICAN
SPECIALTY SURETY COUNCIL

1001 North Highland Street, Suite 101, Arlington, Virginia 22201 • 703 / 528-0072

April 16, 1982

The Honorable Lowell Weicker, Jr.
Chairman, Committee on Small Business
United States Senate
424 Russell Senate Office Building
Washington DC 20510

Dear Senator Weicker:

For The American Specialty Surety Council, I would again like to express our appreciation for being allowed to appear before your committee on March 11, 1982. We are deeply interested in the Surety Bond Guarantee program and are delighted to be able to participate in formulating legislation dealing with the program.

The following answers are in response to your letter of March 18, 1982:

1. Question

SBA does not verify costs behind claim expenses submitted by surety companies. Instead, SBA relies on the honesty and competency of each individual surety. In light of testimony at the hearing from the SBA Inspector General, which indicated that this and reliance on surety companies may be misplaced in many cases, what measures do you recommend to verify the cost of claims, and should SBA place total reliance on surty companies to submit reasonable claim expenses?

Answer

Although SBA does not verify claims expense on a continuing itemized basis, it does make occasional specific inquiries and spot audits of claim files. This could be implemented to request copies of statements from attorneys, adjusters and consultants itemized as to time and nature of services performed. Any necessary verification of items thereon could be obtained from the records of the attorney, adjuster or consultant and from corollary sources.

The Honorable Lowell Weicker, Jr.
Page Two
April 16, 1982

2. Question

Considering that the specialty surety industry is bonding high-risk contractors, using the standard industry loss computation formulas, what, in your opinion, is an acceptable loss ratio for companies participating in the Surety Bond Guarantee program?

Answer

Acceptable surety loss ratios must take into consideration acquisition cost, underwriting, accounting, taxes and other unallocated expense impacting the premium dollar. In the case of SBA-guaranteed bonds, this must also include the 20 percent surety fee paid to SBA. Of course, any loss ratio is dependent upon a number of variable factors, such as volume and spread of risk, and not in the least the overall business economy. In the present climate of recession and attrition, it is to be expected that losses on contract bonds will increase both in frequency and amount. Accordingly, it would appear that an acceptable maximum loss ratio (including loss expense) in the Surety Bond Guarantee program would be a maximum of 280 percent of premium earned.

3. Question

If a surety or agent demonstrates high loss ratios or unethical business practices, should SBA punish the surety or agent by denying guarantees or providing smaller guarantees?

Answer

As indicated in the answer to question 2, the cause of high loss ratios, and the amount thereof within control of the surety, is subject to many variables. As a result, a surety should not be considered in disfavor merely because its loss ratio may increase. If investigation should reveal that such is the result of negligence or unethical business practices in a consistent and frequent manner over a period of time, then certainly that surety should be disciplined.

4. Question

What recommendations do you have for making improvements in SBA's management of the Surety Bond program?

Answer

Apply the law and regulations consistently in all regions and as to all sureties. Put all regional and district SBG personnel on a "post of duty" basis to Central Office, SBA. Reduce or eliminate policy amendments or changes. Issue underwriting and standard operating procedure manuals to all regions and provide sureties with a copy of each.

Since the hearings, the Board of Directors of the association has given considerable thought to the claims process and have developed a resolution which we hope will tend to standardize the claims process among the specialty sureties. A copy of the resolution is attached for your information.

Respectfully,

John Magnotti

John F. Magnotti Jr.
Executive Vice President

JFM/cmr

Attachment: a/s

TASSC

THE AMERICAN
SPECIALTY SURETY COUNCIL

1001 North Highland Street, Suite 101, Arlington, Virginia 22201 • 703 / 528-007

# RESOLUTION ON THE CLAIMS PROCESS IN THE SBG PROGRAM

The officers, directors and members of The American Specialty Surety Council hereby individually and jointly resolve:

That charging unallocated expenses to SBA is not in the best interests of either the surety companies or the government.

That, when processing claims, surety firms should retain control over the claims process, and further, if claims attorneys are used that the attorneys be provided with a theory of the case from the surety company.

That surety companies retain an individual in house who can be identified as the claims manager.

That surety companies or their agents should not derive secondary financial benefits from the claims process which cannot be clearly identified with specific claims files.

That potential conflicts of interest in the claims process will be examined carefully, and eliminated where conflicts are found to exist.

That surety companies or their agents will not authorize legal fee rates in excess of prevailing limits in given geographical areas.

The **Chairman**. Is Don Templeman in the room, or are we having somebody else testify?

All right, fine, whoever is representing the Small Business Administration, if the witnesses would identify themselves, please?

Again, we are very much on the short side, timewise, and I would appreciate it if you would put your statement into the record in its entirety and summarize the statement for us.

## STATEMENT OF EDWIN T. HOLLOWAY, ASSOCIATE ADMINISTRATOR FOR FINANCE AND INVESTMENT, SMALL BUSINESS ADMINISTRATION, ACCOMPANIED BY ARTHUR E. ARMSTRONG, DIRECTOR, OFFICE OF SPECIAL GUARANTEES; AND ROBERT B. WEBBER, ACTING GENERAL COUNSEL, SBA

Mr. **Holloway**. Yes, sir. Mr. Chairman, I am Edwin T. Holloway, Associate Administrator for Finance and Investment.

The **Chairman**. Do you want to pull the microphone up to you, Mr. Holloway?

Mr. **Holloway**. Mr. Don Templeman has been ill the past couple of days, and I will be substituting for him here today.

I am accompanied by Mr. Arthur Armstrong, Director of the Office of Special Guarantees, and by Mr. Bob Webber, who is our Acting General Counsel.

In deference to the time constraints the committee is under, as you pointed out, Senator, I am going to skip over most of this statement and just read a couple of relevant parts of it.

When this program started in 1970, the prevailing philosophy was to operate it with a minimum staff, depending upon the surety industry to apply its standards and procedures to underwriting and claims payments of bonds guaranteed by SBA. This approach was encouraged by a broadly written statute, elaborated upon by equally broadly written regulations.

It should be noted that the establishment of the program anticipated the participation of the standard surety industry. These participants would have been established operations with wide underwriting experience and full-fledged claims departments.

The industry, however, did not respond as anticipated, probably because of the relatively higher cost of handling small contractors. Consequently, a new form of surety arose, the so-called specialty surety, which has been the backbone of the program, although plagued with problems common to new enterprises.

The underlying philosophy of the program has proved unsatisfactory to the Congress and to Agency officials, whose recommendations anticipate a more adequately staffed operation upon which SBA was to depend to do the bulk of work. That the difference between concept and reality has yet to be resolved is further evidenced by legislative restrictions in recent years on SBA's powers to deal with negligent sureties.

I would like to detail some of the Agency actions that have been taken, talk a little about our proposed actions, and get into some of the legislative initiatives that we feel will be necessary for us.

The Agency did publish new regulations on September 17, 1981, and has been developing a new SOP and underwriting handbook, which we'll be issuing within the next 30 to 60 days.

We are developing a proposal for the use of an industry-type computation of the loss rate, which presently is being reviewed by our Office of Policy, Planning and Budget, as has been suggested by the Inspector General's Office.

We've hired a professional surety person, who has employed claims review teams and has aggressively pursued a recovery effort resulting in collection of $10 million in the past 2 years, compared with only $14 million recovered in the previous 9 years.

Three temporary employees have been converted to permanent status, and arrangements are being made to employ four university students on a cooperative, part-time basis. Additional people have been detailed to the surety bond guarantee program.

We've completed some 11 surety reviews since late 1980, compared with 4 made in the previous 9 years. Seventeen cases have been formally referred to the Inspector General for review in the last 18 months.

In addition, we are proposing some additional amendments to the regulations, now being prepared, which will have a tremendously positive effect on SBA's relationship with sureties. A new definition of loss will prevent abuse of the claims process. Presently, the definition of loss includes all expenses in connection with a claim. The new definition will exclude normal overhead of a surety.

The amended regulation will categorize expenses as allocated and unallocated, consonant with industry practice, facilitating the establishment of a loss ratio formula more in line with those practices. This will reduce cash outlays of the Agency in its payment of surety bond guarantee claims.

Mr. Chairman, your letter of invitation to testify at today's hearing asked us to address two specific subjects with regard to sureties and their agents: First, whether specialty companies have the ability to responsibly underwrite bonds and process defaults; and, second, methods at SBA's disposal to remove sureties or agents who do not demonstrate the integrity or acumen necessary to participate in the program.

These two questions are interrelated. If SBA does not have sufficient ability to discipline sureties when they are negligent, when their integrity is in question, or when they prove to be operating at a substandard level, sureties have no reason or incentive to perform at an acceptably high standard.

I would like to take a moment to review some of the governing statutory provisions and then make some recommendations.

First, section 411(d) of the Small Business Investment Act of 1958, as amended, provides that:

"The Administration may establish and periodically review regulations for participating sureties which shall require such sureties to meet Administration standards for underwriting, claim practices, and loss ratios."

As I have indicated, it is our intention to vigorously enforce these provisions through regulations that are now in place, and amendments currently under consideration. This authority allows SBA to refuse to issue guarantees to a surety in specified instances.

Of equal importance to SBA's efforts are the provisions with section 411(e) dealing with denial of liability on claims. If the Agency is going to get control of the claims process, we must have the authority to deny liability or to compromise claims when the surety is in material breach of its contractual obligations with SBA.

Even under our guaranteed loan programs we have such authority, and its occasional use has been necessary to ensure that the lenders acted responsibly and met their obligations under the guarantee agreement.

Public Law 95-507 defined extremely restrictive criteria under which SBA shall be relieved of liability under its surety guarantee. This authority is limited to two instances:

One, when the surety obtained such guarantee or agreement or applied for such reimbursement by fraud or material misrepresentation; or

Two, the total contract amount at the time of execution of the bond or bonds exceeds $1 million, the statutory ceiling.

SBA believes this provision to be unnecessarily restrictive, basically tying the Agency's hands in instances when the surety has materially breached its agreement. We at SBA believe, therefore, that the committee should seriously consider amending this section to provide broader authority for SBA to deny liability or negotiate payments in proven instances of material breach on the part of the surety or agent.

The Agency also believes SBA should have the authority to review the character and reputation of program participants, sureties and agents. Regulatory authority as outlined in section 411(d) could be clarified to specifically include reference to evaluating character and reputation.

With these authorities, even if implemented only in rare instances, we believe the sureties would recognize that they must meet certain standards or face stiff consequences.

Mr. Chairman, our staff will look forward to working with your staff in terms of appropriate legislation in this area.

This completes my prepared statement, and we will try to answer any questions.

The CHAIRMAN. All right. Thank you very much.

We've heard a great deal of disturbing information about AFFI and its former managing agent, Market Insurance Corp.

On January 15, 1982, Arthur Armstrong, Director of the Office of Special Guarantees, drafted a letter to Arthur Bernstein, an owner of Market Insurance. The letter informs Market that SBA is removing the company from the program. I understand that the letter was never sent. Why?

Mr. HOLLOWAY. Mr. Armstrong is here with me this morning, and I would like to ask him to respond to that question.

Mr. ARMSTRONG. The letter was prepared—it was quite a long letter, actually—and referred to our Legal Division for legal clearances to do what we could do. (See exhibit VI beginning at p. 472.)

The reason for the letter was that last summer it came into our hands that the California State Insurance Commission, whatever its official title is, had brought charges against Mr. Bernstein, who was operating as Market.

The letter itself said that what we wanted was an explanation of what was going on between Market and the State Insurance Commission. There probably was a veiled threat in there that if you don't straighten up, if you don't respond satisfactorily, we'll have to take steps to remove you from the program.

Under existing regulations, even though they're new, as I understand it from the Legal Division, we could not use that letter because the evidence we had—that is, the charges, the documents—did not relate the wrongdoing to SBA, but rather to his general business operation, so the letter did not go, even though I was ready to send it out.

The CHAIRMAN. The California Department of Insurance has informed my staff that Market has agreed to settle their case for a $25,000 fine, and by doing so has accepted the findings of the Department that Market has violated the insurance code of California by maintaining premium funds out of trust and using those funds for unallowable investments.

Furthermore, the department of insurance found that the owners of Market, quote, "do not display the character, competency or integrity necessary and sufficient to manage and operate a licensed exchange," end of quote. In light of this agreement to settle, does SBA now plan any action against Market? (See exhibit VII beginning at p. 475.)

Mr. ARMSTRONG. I think when we get the evidence of what has happened, the documentation and so forth, from the commission, from what you're saying, that we will turn that documentation over to our Legal Department and see what our proper steps can be within the regulation and law as it stands right now.

The CHAIRMAN. I have a memorandum from the surety bond guarantee office's internal files. It's entitled "Exorbitant Legal Expenses." The memorandum mentions the fact that Balboa, a large surety company, is raising its legal expenses charged to SBA to $80 an hour. The memorandum states, quote: "In a time of inflation and generally rising costs, the increase noted is not surprising. Balboa and its attorney charges, however, are not presently causing concern, given its low, 4.5 percent loss ratio. The total amount expended by AFFI for attorney fees, on the other hand, is a matter of great concern to me, and requires our immediate attention. With a loss ratio of 61.7 percent, third highest among the 10 most active participating sureties, we should ask pointed questions about AFFI's judgment in default situations." (See exhibit VIII beginning at p. 480.)

What are you doing about AFFI's legal costs?

Mr. HOLLOWAY. Mr. Chairman, I might say at this point that many of the—the thrust of the testimony of the Inspector General is accepted by me. We've got a lot of work to do in this surety bond guarantee program.

Management of the program will require a review of existing regulations, proposed regulatory changes, SOP rewrites, the issuance of the underwriting and claims handling manuals, things of that sort, as well as a treaty to be entered into with the sureties themselves. It's going to be a tough job and a lot of work to get this all done in a way that is fair, that gives due process to everybody concerned, and that makes the needed program adjustments.

Back to the issue of attorneys' fees, we will deal with the issue of attorneys' fees as a part of the necessary changes in our controlling regulations and SOP's.

That would be my response to that question.

The CHAIRMAN. I want to point out, however, this is the second go-around on this program. Now, I realize that much of what went before was brought to public attention in the previous administration. However, it was also brought to the attention of those representing this administration. So I want to make clear that I'm not willing to sit by and let another year go by the boards, and then end up right back in the same room with another $20 million that's gone out the window.

I think the time to blow the whistle, as I indicated, is right this minute, and this is not something that can be dragged out.

I will certainly cooperate with the Administrator—and I might add, we're certainly fortunate with the person we have coming into place, considering his insurance background—I'll be glad to cooperate for whatever is needed legislatively, whatever is needed, either as far as SBA is concerned or as far as Treasury is concerned, and we'll do our part, but I don't think this thing needs much more investigation.

I think you've got an Inspector General over there who has enough horror stories to keep us all going around here for the best part of a year. I think that they all come back to a half a dozen points of friction, if you will, which now need to be corrected.

Mr. HOLLOWAY. Mr. Chairman, I accept what you're saying, and I can assure you that prior to accepting this position some 3 weeks ago, the Administrator-designate, Mr. Sanders, made it clear to me and gave me my marching orders that he wants it straightened up, and that's exactly what I propose to do.

I believe that the resources will be made available. We will be able to do the things that we need to do administratively within the agency, in terms of proposing additional authorities that we need here, and any other steps that are necessary, resourcewise, we will have the priority with our new Administrator and, in fact, right now with our Acting Administrator.

The CHAIRMAN. Let me put on my other hat. I also sit as Chairman of the Appropriations Committee that handles this agency's budget. I don't mean to in any way denigrate college students, but this is a highly, highly complex field. With all my staff around me, I'm still not so sure I totally understand it, and I've been dealing with it for the best part of a couple of years. I think if we're going to get at the problems we're going to need some people from the industry who know what they're talking about, and not have just college students working on this program. I just want to let you know that from an appropriations point of view whatever you need in the way of resources to get this program cleaned up, we will allocate them, because they're minuscule. They're minuscule compared to the millions that are involved.

Mr. HOLLOWAY. You're exactly right, Senator, and when we have a program like this that we're looking to the private sector to carry out, it is very, very significant, because this is the same direction we're moving in most of our other programs. If we're to be able to delegate to the private sector and yet not abdicate our responsibilities, we're going to have to have a significant overview and evaluation capability from a program point of view. I'm talking about program people doing monitoring, evaluation and auditing, not the investigation that is done at the end of the process by the Inspector General.

Certainly, anything that we get that should be referred to the Inspector General for an investigation will be referred immediately. However, I believe that we can do a lot more by bringing additional resources to the problem. Specifically, I'm exploring further private sector involvement in the form of contracting out some of the ability to selectively audit, if you will, from a program point of view what's happening with the claims handling out there in these individual sureties.

I don't believe that this is not doable. What we're going to undertake to do is doable. It's doable with some very standard management practices, and perhaps some additional legislation, which our staff will work with your staff, and I'm sure that we can get that accommodated.

The CHAIRMAN. And some expertise.

Mr. HOLLOWAY. And expertise.

The CHAIRMAN. I mean, the problem here is—and, again, this was correctly pointed out by those representing the industry and by the attorneys who work with the industry—we're talking about only a small percentage that are bad eggs. The fact remains that these few are trying to rip off the Government. Now, if you're going to nail them, you've got to know as much as they know, and that is the problem. SBA doesn't know as much as they know, and that's the reason why SBA is being had. So I want to make sure that you've got people administering this program who know just as much as the people who are trying to use it in a wrongful way.

Mr. HOLLOWAY We do need a very capable claims handler and a claims handling specialist from the private sector to be a part of the monitoring and evaluation and overview even of what we get private sector contractors to do.

The CHAIRMAN. And we can amend immediately this practice of college students getting these forms and just saying, "Paid," and writing out the checks? That's what goes on right now. Well, I don't want to say goes on right this minute, but it did up until several weeks ago. They just would receive the forms that have been made a part of the record by the Inspector General, write out the check and send it out.

Mr. HOLLOWAY. We can and will, Senator, tighten up further on the documentation necessary.

I would point out again, however, that back in 1978, it was a very conscious intent at that time to make it really impossible for SBA not to pay unless we could prove, up front, fraud or material breach. And this is where we are.

The CHAIRMAN. And there you deserve the cooperation of the Congress in going ahead and tightening up that language. There's no question about that.

Mr. HOLLOWAY. Yes.

The CHAIRMAN. All right, the rest of these questions will be submitted for the record.

[The prepared statement of Mr. Holloway and subsequent information follow:]

## STATEMENT OF EDWIN T. HOLLOWAY, ASSOCIATE ADMINISTRATOR FOR FINANCE AND INVESTMENT

Mr. Chairman and members of this committee, I appreciate the opportunity to appear today and discuss the Small Business Administration's Surety Bond Guarantee Program. I am Edwin T. Holloway, Associate Administrator for Finance and Investment, and with me today are Robert B. Webber, Acting General Counsel, and Arthur Armstrong, Director, Office of Special Guarantees.

I believe we are all familiar with the basic structure and operation of the Surety Bond Guarantee Program. In the interest of time I will not review these procedures but will go right into those areas which are the subject of today's hearing.

### UNDERLYING PROGRAM DESIGN

When the Surety Bond Guarantee Program, SBA's second largest guarantee program, was established on December 31, 1970, the prevailing philosophy was to operate it with a minimum staff, depending upon the surety industry to apply its standards and procedures to underwriting and claims payments of bonds guaranteed by SBA. This approach was encouraged by a broadly written statute elaborated upon by equally broadly written regulations. To avoid establishing a bureaucracy to evaluate and authorize sureties to obtain our guarantee, the decision was made to use the Treasury Circular 570 (Published Annually) which lists acceptable sureties on Federal bonds. There are approximately 300 sureties listed, over 60 of which have participated in the SBA program.

It should be noted that the establishment of the program anticipated the participation of the standard surety industry. These participants would have been established operations with wide underwriting experience and full-fledged claims departments. The industry, however, did not respond as anticipated probably because of the relatively higher cost of handling small contractors. Consequently, a new form of surety arose, the so-called specialty surety which has been the backbone of the program although plagued with problems common to new enterprises.

These problems have attracted the attention of various investigative bodies.

During the intervening years, this underlying philosophy has proved unsatisfactory to the Congress and to agency officials whose recommendations anticipate a more adequately staffed operation upon which SBA was to depend to do the bulk of work. That the difference between concept and reality has yet to be resolved is further evidenced by legislative restrictions in recent years on SBA's powers to deal with negligent sureties.

By contrast the various oversight actions during this time have indeed revealed the necessity for better and closer control of a program recognized as both useful and vital to small business.

### AGENCY ACTIONS

As a result of this Committee's 1980 inquiry along with a 1979 GAO audit and a 1980 Inspector General investigation the Agency initiated a series of actions to improve program management including:

(1) Promulgation of new regulations published on September 17, 1981 and development of the new SOP and underwriting handbook, which we will be issuing within 30 to 60 days.

(2) Development of a proposal for the use of an industry-type computation of the loss rate which presently is being reviewed by our Office of Policy, Planning and Budget.

(3) We have hired a professional surety person, who has employed claims review teams and has aggressively pursued a recovery effort resulting in collection of $10 million in the past two years compared with only $14 million recovered in the previous nine years.

(4) Three temporary employees have been converted to permanent status and arrangements are being made to employ four university students on a cooperative, part-time basis. Also three regular SBA employees have been detailed to the Surety Bond Guarantee Branch for 60 to 120-day periods.

(5) We have completed 11 surety reviews since late 1980 compared with four made in the previous nine years. Seventeen cases have been formally referred to the Inspector General for review in the last 18 months.

The new regulations better define a surety (e.g., a surety and its agents are one and the same for our purposes). They permit variance of terms and conditions from surety to surety, and permit audits of sureties by SBA. Oral guarantee approvals are now forbidden, except for the non-contiguous states and possessions, as is the issuance of guarantees where work is underway. Some sanctions against wayward sureties for excessive losses are also permitted.

A surety treaty is presently in draft which would supersede the existing individual case-by-case guarantee agreement (Form 990) used by SBA with participating sureties. This important step will define the underlying agreement common to all such guarantees in the handling, justification, accounting and administration of the program. As currently drafted it is adaptable to individual surety company variables and spells out SBA and surety rights and obligations. It covers such items as percentage of guaranty, rights of parties, application and approval of guarantees, loss mitigation. loss handling, expenses and salvage, fees, reports and remittances, records, investigation, termination and compliance with laws and regulations.

## PROPOSED ACTIONS

Amendments to the new regulations are now being prepared which will have a tremendously positive effect on SBA's relationship with sureties. A new definition of loss will prevent abuse of the claim process. Presently, the definition of loss includes all expenses in connection with a claim. The new definition will exclude normal business overhead of a surety.

The amended regulation will categorize expenses as allocated and unallocated consonant with industry practice, facilitating the establishment of a loss ratio formula more in line with those practices. This will reduce cash outlays of the Agency in its payment of surety bond guarantee claims.

Henceforth contractors would submit their fee to the surety company which would in turn account for it to the Small Business Administration along with the surety premium. This requirement would simplify fee collection, reducing costs to all concerned.

The Office of Special Guarantees has requested that regular Field Reviews include an evaluation of various aspects of the surety program.

SBA will meet the need for qualified claims adjustment personnel through employing and/or contracting for the additional staff required. Also, data processing support of our claims procedures will be improved to permit closer monitoring of claims paid against a contract.

## LEGISLATIVE INITIATIVES

Mr. Chairman, your letter of invitation to testify at today's hearing asked us to address two specific subjects with regard to sureties and their agents. First, whether speciality companies have the ability to responsibly underwrite bonds and process defaults; and second, methods at SBA's disposal to remove sureties or agents who do not demonstrate the integrity or acumen necessary to participate in the program.

These two questions are interrelated. If SBA does not have sufficient ability to discipline sureties when they are negligent, when their integrity is in question or when they prove to be operating at a substandard level, sureties have no reason or incentive, to perform at an acceptably high standard.

I would like to take a moment to review some of the governing statutory provisions and then make some recommendations. First, section 411(d) of the Small Business Investment Act of 1958 as amended by P.L. 95-507 provides that:

"The Administration may establish and periodically review regulations for participating sureties which shall require such sureties to meet administration standards for underwriting, claim practices, and loss ratios".

As I have indicated, it is our intention to vigorously enforce these provisions through regulations that are now in place, and amendments currently under consideration. This authority allows SBA to refuse to issue guarantees to a surety in specified instances.

Of equal importance to SBA's efforts are the provisions of 411(e) dealing with denial of liability on claims. If the Agency is going to get control of the claims process, we must have the authority to deny liability or to compromise claims when the surety is in material breach of its contractual obligations with SBA.

Even under our guaranteed loan programs we have such authority and its occasional use has been necessary to insure that the lenders acted responsibly and met its obligations under the guarantee agreement.

P.L. 95-507 defined extremely restrictive criteria under which SBA shall be relieved of liability under its surety guarantee. This authority is limited to two instances:

(1) When the surety obtained such guarantee or agreement or applied for such reimbursement by fraud or material misrepresentation, or

(2) The total contract amount at the time of execution of the bond or bonds exceeds $1,000,000.

SBA believes this provision to be unnecessarily restrictive, basically typing the Agency's hands in instances when the surety has materially breached its agreement. We at SBA therefore believe that the Committee should seriously consider amending this section to provide broader authority for SBA to deny liability or negotiate payments in proven instances of material breach on the part of the surety or agent.

The Agency also believes SBA should have the authority to review the character and reputation of program participants (sureties and agents). Regulatory authority as outlined in Section 411(d) could be clarified to specifically include reference to evaluating character and reputation.

With these authorities, even if implemented only in rare instances, we believe the sureties would recognize that they must meet certain standards or face stiff consequences.

Mr. Chairman, this concludes my prepared remarks and I would be happy to answer any questions you might have.

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U.S. Small Business Administration,
Office of the Administrator,
*Washington, D.C., March 31, 1982.*

Hon. Lowell Weicker, Jr.,
*Chairman, Committee on Small Business,*
*Washington, D.C.*

Dear Mr. Chairman: Acting Administrator Templeman has referred your letter of March 18, 1982, containing questions and comments relative to the recent hearings on the Small Business Administration Surety Bond Program. I am pleased to provide the Agency's responses which are as follows:

### QUESTIONS

(1) "I understand that SBA is concerned about exorbitant legal expenses charged to the agency by the American Fidelity Fire Insurance Company. What action has SBA taken regarding these legal costs?"

SBA plans to deal with excessive legal costs and other expenses in connection with losses by redefining "loss" and by requiring prior written approval of expected litigation cost before surety engages in litigation.

(2) "What action will SBA take in the future regarding sureties which consistently handle claims in a manner which leads to excessive losses?"

When a particular surety's loss experience under the program has been unsatisfactory, SBA may notify the surety company that SBA will consider guarantees only on more restrictive terms and conditions which apply especially to the surety. By this action, now authorized by regulations, SBA expects to decrease materially the government's risk on a surety's bond.

(3) "What steps is SBA taking to establish underwriting guidelines?"

At the present time, the Surety Bond personnel are preparing an underwriting handbook and a claims handbook. A new guarantee agreement will require sureties to process applications from contractors and claims from obligees in accordance with the guidelines in the handbooks.

(4) "In the future, how will SBA verify underwriting information and claims expenses submitted by surety companies?"

Underwriting information furnished by sureties will be evaluated in accordance with the guidelines of the handbook by SBA's surety bond guarantee officials in field offices. While selected claims will be audited with increased frequency, SBA has no plans to verify each and every expense connected with or allocable to each claim for loss.

(5) "What methods does SBA have at its disposal to remove a poorly operated surety company from the guarantee program?"

The method is provided by 13 CFR 115.3. The Director, Office of Special Guarantees, may refuse to issue a further guarantee to a surety upon finding: Fraud or material misrepresentation; imprudent underwriting standards; and removal of a surety company from the "Treasury List" by the Treasury.

Other sanctions may be imposed for excessive losses (as compared with other participants). A thirty day rebuttal period is provided, and an appeal may be made to the SBA Associate Administrator for Finance and Investment.

(6) "What action does SBA plan to take regarding Market Insurance Corporation?"

A letter was sent to Mr. Bernstein asking for an explanation in regard to the SBA Surety Bond Program, and his problem with the California Life Insurance Commission. We are awaiting his response.

(7) "I understand Mr. William Ballay has applied for participation in the Surety Bond Program. Will SBA accept Mr. Ballay's application, in light of the findings concerning his association with the American Bonding Agency, which was explored at the Committee's September 25, 1980 hearing on the Surety Bond Guarantee Program?"

SBA wrote Mr. Ballay on March 19, 1982 advising that based on its experience with him as a surety in connection with Chicago Automatic Machine Co., Inc., it would enter into a guarantee of bonds based on applications produced by him only upon receiving 25% of the premium and guaranteeing not more than 50% of the loss.

## COMMENTS

(1) "SBA should inject experienced, additional personnel into the Surety Bond. The new personnel should include a professional claims adjuster to establish a more vigorous claims operation and train current staff. Also, the program should maintain a level of consistency regarding personnel. Although inexperienced people are placed in the program, they eventually become trained as surety experts. Yet once they are properly trained, they are often transferred to other SBA programs."

SBA agrees, and 3 temporary employees have already been converted to permanent status. We expect to add a professional claims investigator in the near future, and have detailed regular SBA personnel to bolster the present staffing until further long-term changes can be accomplished.

(2) "SBA regulations should be implemented uniformly across the country. Directives from the Central Office involving regulatory changes have received varying interpretations by each region and district. As a result, contractors who could receive a bond in one district do not qualify in another."

We agree, and steps are being taken to bring about more uniformity of policy implementation in the field offices.

(3) "A portion of the claims processing should be handled at the District or Regional levels. It is illogical for the Central Office to process all claims from such a geographically remote position."

We do not believe decentralized claims processing is feasible. It would aggravate our present accounting and control problems. Instead, we believe incorporation of specialized personnel into the central claims operation is more suitable.

(4) "SBA should consider underwriting the participating sureties rather than contractors. If the sureties are required to uphold minimal standards of loss performance, then it follows that they will be forced to aggressively underwrite the contractors. As part of underwriting the sureties, a treaty should be established, which would penalize the surety companies for high loss ratios by lowering guarantee percentages or denying guarantees all together."

SBA is in the final stages of drafting a Treaty. The Office of General Counsel has reviewed the Treaty and suggested changes. The Surety Bond Program people have comments regarding these changes. These differences will have to be resolved before the Treaty is acceptable, and are receiving priority attention.

(5) "SBA should deny liability on claims where a surety acted negligently."

SBA believes breach of the guarantee contract would be the appropriate cause for denial of liability.

Presently, P.L. 95-507 is unnecessarily restrictive, basically tying the Agency's hands in instances when the surety has materially breached its agreement. We therefore expect to ask the Committee seriously to consider amending this section to provide broader authority for SBA to deny liability or negotiate payments in proven instances of material breach on the part of the surety.

(6) "SBA should require regular status reports on contractors. Job status should be checked at least once a month."

This suggestion is impractical. It is the legal duty of the surety to service the bonds.

(7) "Competitive bidding should be required on all completion contracts to avert the possibility of fraud or inflated costs. A minimum of three bids should be required. If three bidders cannot be found, this rule could be waived only after a complete explanation from the claims adjuster."

SBA is considering a requirement for sureties to obtain competitive bids to complete bonded contracts in default. Such a procedure, however, may be objectionable because of penalty clauses in contracts which exacerbate loss during the period needed to advertise and obtain bids.

(8) "SBA should develop guidelines to tighten its payment of legal costs. As part of these guidelines, SBA should require complete documentation of legal costs and explanations for each step taken by a claims attorney."

This comment is similar to question 1 above. Further restriction could be made by an improvement of the statutory meaning of loss which is somewhat vague. Complete documentation and explanations would be counter-productive because attorneys would charge for their time and efforts in furnishing this material.

(9) "SBA should establish a graduation program for contractors. Sureties have no incentive to graduate contractors to the private market because they would lose clients as a result."

The comment misconceives the graduation concept. It is more expensive for a contractor to obtain a bond with SBA assistance then it is to obtain a bond without such assistance. The contractor meeting the credit criteria of standard surety companies has great incentive to graduate.

Sincerely,

EDWIN T. HOLLOWAY,
*Associate Administrator for*
*Finance and Investment.*

I would like the record to reflect that all documents referred to during the hearing will be made a part of the hearing record.

The CHAIRMAN. In addition, the record will remain open for a time to receive responses to those questions that have been offered for the record, for the inclusion of any other comments that might come to the committee.

Thank you all very much.

The committee will stand in recess.

[Whereupon, at 12:04 p.m., the committee recessed, to reconvene at the call of the Chair.]

[The exhibits referred to follow:]

Exhibit I

JACE INDUSTRIES, INC.
333 NORTH BROADWAY JERICHO, N.Y. 11753
(516) 433-8059

July 18, 1977

International Fidelity Insurance Company
24 Commerce Street
Newark, New Jersey 07102

Re: Repair of Powder Point Bridge
Duxbury, Ma.
July 8, 1977 thru July 15, 1977
Requisition No. 7

| ITEM | DESCRIPTION | WORK COMPLETED | UNIT PRICE | TOTAL |
|---|---|---|---|---|
| II | Timber Piles | 80 LF | $ 10 LF | $ 800.00 |
| IV | Timber Removed | 26.294 | 300MBFM | $ 7,888.20 |
| V | Pile to Pile Cap Conn. | 178 EA | 300MBFM | $ 53,400.00 |
| VI | Cross Bracing New | 3.08MBFM | 3,300MBFM | $ 10,164.00 |
| VII | Cross Bracing reset | 1 MBFM | 3,300MBFM | $ 3,300.00 |
| VIII | Cross Bracing Splice | 12 EA | 200 EA | $ 2,400.00 |
| X | Pile Cap New Side Rail | 0.243MBFM | 4,000MBFM | $ 972.00 |
| XIIA | Stingers New | 1.68MBFM | 4,000MBFM | $ 6,720.00 |
| | Cutoffs | 4 EA | 200 | $ 800.00 |
| XIIIB | Stringers Reused | 0.343MBFM | 4,000MBFM | $ 1,372.00 |
| XIIIA | Decking New | 5.534MBFM | 4,500MBFM | $ 24,903.00 |
| XIIIA | Decking New (nailing only) | 85% | 18,470 | $ 15,699.50 |
| XIIIB | Decking Reused | 33.863MBFM | 350MBFM | $ 11,852.05 |
| XIVA | Curbing New | 7.435MBFM | 600MBFM | $ 4,461.00 |

Page Two
Requisition No. 7
July 18, 1977

| ITEM | DESCRIPTION | WORK COMPLETED | UNIT PRICE | TOTAL |
|---|---|---|---|---|
| XIVB | Curbing Used | 6.593MBFM | $ 60MBFM | $ 395.58 |
| XVA | Railings New | 2.385MBFM | 500MBFM | $ 1,192.50 |
| XVB | Railings Reset | 318.17 LF | 5.00LF | $ 1,590.85 |
| XVII | Outside Stringers | 4.256MBFM | 4,000 | $ 17,024.00 |
| | Overhead | | | $ 10,000.00 |
| | Mobilization | | | $ 20,000.00 |
| | | | | $ 194,934.68 |
| | | Retainage | | $ 3,926.44 |
| | | | | $ 191,008.24 |
| | | Material Prepaid | | $ 15,567.02 |
| | | | | $ 175,441.22 |
| | | Previous Payments | | $ 152,782.89 |
| | | TOTAL AMOUNT DUE | | $ 22,658.33 |

# CHANGE ORDER

AIA DOCUMENT G701

OWNER ☒
ARCHITECT ☐
CONTRACTOR ☐
FIELD ☐
OTHER

PROJECT: Powder Point Bridge
(name, address) Duxbury, Mass.

CHANGE ORDER NUMBER: 3

TO (Contractor)

International Fidelity Insurance Co.
c/o J. Steinfield
Hill & Barlow
225 Franklin Street
Boston, Mass.

ARCHITECT'S PROJECT NO: 752608

CONTRACT FOR: Bridge Rehabilitatio

CONTRACT DATE:

You are directed to make the following changes in this Contract:

| | |
|---|---|
| Item V | Pile to Pile Cap Connections - Add 50 connections including 4 which are to be reserved for 4 piles yet to be installed. |
| Item VIII | Cross Bracing Splice - Add 12 @ $50.00 each. |
| Item XIIA | Stringers New - Add 2.14 mbfm @ $600/mbfm |
| ~~Item XIIIA~~ | ~~Decking New - Add 8.53 mbfm @ $150/mbfm~~ |
| Item XIVA | Curbing New - Add 4.78 mbfm @ $550/mbfm |
| Item XIVB | Curbing Reused - Credit 3.13 mbfm @ $100/mbfm |
| Outside stringers (North & South) 3.99 mbfm @ $3000/mbfm | |

The purpose of this change order is only to provide a basis for payment for the above referenced items of work should they be required by the Owner/Engineer and does not commit the Owner/Engineer to employ these items of work. Any work directed to be accomplished by the engineer relating to the above referenced items if required shall be accomplished by 29 July 1977.

Daily work sheets will be submitted by the contractor to the engineer for all work accomplished whether the work is a payment item for the town or not.

The original Contract Sum was . . . . . . . . . . . . . . . . . . . . $

Net change by previous Change Orders . . . . . . . . . . . . . . . . . $

The Contract Sum prior to this Change Order was . . . . . . . . . . . . $

The Contract Sum will be (increased) (decreased) (unchanged) by this Change Order . . . $

The new Contract Sum including this Change Order will be . . . . . . . . $

The Contract Time will be (increased) (decreased) (unchanged) by ( ) Days.

The Date of Completion as of the date of this Change Order therefore is

ARCHITECT: Geotechnical Consultants, Inc.
Address: One Richardson Lane
Stoneham, Massachusetts
02180
BY W C Emerson
DATE 27 June 1977

CONTRACTOR
Address
BY
DATE

OWNER
Address
BY
DATE

# CHANGE ORDER

AIA DOCUMENT G701

OWNER ☒
ARCHITECT ☐
CONTRACTOR ☐
FIELD ☐
OTHER ☐

PROJECT: Powder Point Bridge
(name, address) Duxbury, Mass.

CHANGE ORDER NUMBER: 3

TO (Contractor)

International Fidelity Insurance Co.
c/o J. Steinfield
Hill & Barlow
225 Franklin Street
Boston, Mass.

ARCHITECT'S PROJECT NO: 752608
CONTRACT FOR: Bridge Rehabilitatio
CONTRACT DATE:

You are directed to make the following changes in this Contract:

| | |
|---|---|
| Item V | Pile to Pile Cap Connections - Add 50 connections including 4 which are to be reserved for 4 piles yet to be installed. |
| Item VIII | Cross Bracing Splice - Add 12 @ $50.00 each. |
| Item XIIA | Stringers New - Add 2.14 mbfm @ $600/mbfm |
| Item XIIIA | Decking New - Add 8.53 mbfm @ $150/mbfm ⇐ |
| Item XIVA | Curbing New - Add 4.78 mbfm @ $550/mbfm |
| Item XIVB | Curbing Reused - Credit 3.13 mbfm @ $100/mbfm |
| Outside stringers (North & South) 3.99 mbfm @ $3000/mbfm | |

The purpose of this change order is only to provide a basis for payment for the above referenced items of work should they be required by the Owner/Engineer and does not commit the Owner/Engineer to employ these items of work. Any work directed to be accomplished by the engineer relating to the above referenced items if required shall be accomplished by 29 July 1977.

Daily work sheets will be submitted by the contractor to the engineer for all work accomplished whether the work is a payment item for the town or not.

The original Contract Sum was . . . . . . . . . . . . . . . . . . . . . $
Net change by previous Change Orders . . . . . . . . . . . . . . . . . $
The Contract Sum prior to this Change Order was . . . . . . . . . . . . $
The Contract Sum will be (increased) (decreased) (unchanged) by this Change Order . . . $
The new Contract Sum including this Change Order will be . . . . . . . . $
The Contract Time will be (increased) (decreased) (unchanged) by ( ) Days.
The Date of Completion as of the date of this Change Order therefore is

| | | |
|---|---|---|
| Geotechnical Consultants, Inc. | | |
| ARCHITECT | CONTRACTOR | OWNER |
| One Richardson Lane | | |
| Address Stoneham, Massachusetts 02180 | Address | Address |
| BY M C Emerson | BY | BY |
| DATE 27 June 1977 | DATE | DATE |

Exhibit II

LIEB, WOLFF & SAMSON
A PROFESSIONAL CORPORATION
ATTORNEYS AT LAW
80 MAIN STREET
WEST ORANGE, NEW JERSEY 07052
201-325-2700

DAVID SAMSON
JOEL A. WOLFF
L. ROBERT LIEB
ELLEN B. KULKA
MICHAEL B. GOODMAN *
JOHN E. FINNERTY

* MEMBER OF NEW YORK BAR ONLY

NEWARK OFFICE
10 COMMERCE COURT
NEWARK, NEW JERSEY 07102

March 8, 1976

Mr. Fred Mitterhoff
International Fidelity Ins. Co.
24 Commerce Street
Newark, New Jersey 07102

Re: State Mechanical Co., Inc.
Obligee: City of Newburgh - Public Safety Building
Bond #005582, dated July 8, 1974
Amount: $343,553.00
Reinsurance: SBG #20181-03

Dear Mr. Mitterhoff:

I am enclosing herewith recommendations from your contractor, Progress Builders, Inc., with respect to amounts due to subcontractors and materialmen on this project. It would appear that these recommendations for payment have been made by your contractor on the basis of what is necessary in order to complete the project. We have not reviewed the specifics of the claims involved nor have we made any independent determination as to their respective merit.

On the basis of your contractor's recommendations, we would request that you issue your checks as follows:

| | | | | |
|---|---|---|---|---|
| a) | Elmsford Sheetmetal Works | - | $ 16,182.00 | Ma-B-659 |
| b) | " " " | - | $ 4,800.00 | " " - 700 |
| c) | Jersey Insulation Corp. | - | $ 12,240.00 | Rg. 5763 |

You will note that Progress Builders has also made a request for payment to Powers Regulator Company in the amount of $13,275, which we previously requested by our letter of

3/11/76

February 26, 1975. Kindly forward this check as well, together with your letter agreement.

Very truly yours,

LIEB, WOLFF & SAMSON

DAVID SAMSON

DS:jet

Enc.

Exhibit III

**U.S. SMALL BUSINESS ADMINISTRATION**
WASHINGTON, D.C. 20416

OFFICE OF THE INSPECTOR GENERAL

Date:

To: R. R. Reusche
Assistant Inspector General
for Investigations

From: Terry Crisp
Investigator

Subject: William W. Bowling, Director
Office of Security and Investigations

Expenses Relating to SBG Defaults Processed
By United Inspection Bureau (UIB)

During a survey of the SBG Program I interviewed Mr. Perry Lisker, Manager of UIB, 15910 Ventura Boulevard, Encino, California. Mr. Lisker related the functions of UIB as being a bookkeeping and monitoring system. Mr. Lisker stated that he employs local attorneys throughout the country to adjust and litigate any defaulted surety bonds written by American Fideiity Fire Insurance Co. (Market Insurance Corp.). He further employs three attorneys in his office to review and approve the actions of the local attorneys.

I asked Mr. Lisker what his service was costing the SBA and he related that since it was the policy of the SBA not to reimburse for administrative costs of processing the claims, that he only charged for real time of the attorneys employed by UIB, this included time spent by himself as well. Mr. Lisker explained that the costs were computed in quarter hour increments at the rate of $75.00 an hour for the attorneys and $85.00 an hour for Mr. Liskers time.

Mr. Lisker furnished records of time and billing sheets reflecting the time of his attorneys by SBA bond number. He also furnished monthly consolidations of the time sheets. The sheet reflected that the attorneys always showed at least 40 hours of chargeable time to SBA per week or $3,000.00 per attorney, for a yearly cost of $468,000.00. Mr. Lisker related that his chargeable time is only 60% of his total time or 1248 hrs per year, or $106,080.00. Mr. Lisker also stated that due to the backlog of UIB he also encourages his attorneys to work overtime to close default files, he allows a maximum of 25 hrs per attorney per month. He said that this averages about 20 hrs per attorney per month or 720 hrs per year for a cost of $54,000.00.The total billable time to SBA as calculated from the above information is $628,080.00 per year.

During further conversations with Mr. Lisker, he related that his attorneys were exceptional ones. He said that he paid them 30 to 40 thousand dollars a year therefore he could attract good lawyers.

Based on the information above I recommend a determination be made of the appropriateness of these charges made by UIB under the guise of legal time which appears to be administrative time. Even if this time is a chargeable legal expense it appears SBA is paying $628,000.00 for legal time that is costing UIB $120,000.00.

Please advise of your required distribution.

Terry Crisp
Investigator

Exhibit IVa

The State of New Hampshire

Insurance Department
169 Manchester Street
Concord, N.H. 03301
603-271-2261

Frank E. Whaland
Commissioner

February 12, 1982

The Honorable Lowell Weicker, Jr., Chairman
Committee on Small Business
Washington, D.C. 20510

Dear Senator Weicker:

I have your letter of February 6, and the answers to your questions are as follows:

1. American Fidelity Fire Insurance Company non-renewed its license on April 1, 1972. They made application the following year for readmission. According to our records, this was denied, and it would appear that it was because of their financial situation and poor record in handling claims. These were the predominant factors for denial.
2. Inasmuch as the company is not licensed, there are no restrictions.
3. Same as No. 2.

Sincerely,

Frank E. Whaland
Commissioner

FEW/cc

Exhibit IVb

**STATE OF CONNECTICUT**
*INSURANCE DEPARTMENT*

February 18, 1982

The Honorable Lowell Weicker, Jr.
United States Senator
313 Russell Senate Office Building
Washington, D.C. 20510

Dear Senator Weicker:

In accordance with your request of February 6 concerning the American Fidelity Fire Insurance Company, we offer the following comments:

(A) "Servicing of Existing Business". This authority does not permit the Company to solicit new business or renew business in Connecticut. As of September 30, 1981, the Company reported no Connecticut premiums. Therefore, the Company is effectively dormant in this state.

(B) July 31, 1975 - authority for Automobile Liability (B.I. & P.D.) deleted. November 29, 1976 - all lines of business restricted.

(C) Concern about the Company's financial condition. You will find attached copies of pages from the Company's Report of Examination as of December 31, 1978 relative to the Small Business Administration Surety Guaranty Program. The Report became official on July 21, 1981 and was received by the Department on August 3, 1981.

Please feel free to contact me if you require additional information.

Very truly yours,

Joseph C. Mike

Joseph C. Mike
Commissioner

JCM:g
encl.

*Phone:*
P.O. Box 316, State Office Building, Hartford, Conn. 06115
*An Equal Opportunity Employer*

Exhibit IVc

COMMISSIONER

DEPARTMENT OF THE TREASURY
FISCAL SERVICE
BUREAU OF GOVERNMENT FINANCIAL OPERATIONS
WASHINGTON, D.C. 20226

October 29, 1980

The Honorable
Lowell Weicker, Jr.
United States Senator
Washington, D. C. 20515

Dear Senator Weicker:

Thank you for your letter of September 25, 1980 concerning allegations made against an insurance company during recent hearings of the Senate Select Committee on Small Business.

As we discussed in our telephone conversation of September 29th, the Bureau has a quite narrow and precise mandate concerning issues which may be examined when determining whether an insurance company is approved to act as surety on Federal bonds. The authority to revoke a company's certificate (which in this particular case has been in effect for approximately 69 years) is equally limited.

The statutes which govern the Bureau authority appear at 6 U.S.C. 6-13. Stated briefly, an insurance company must:

1. Be chartered and approved by a State;
2. Have authority under its charter to do surety bond business;
3. Have paid up capital of not less than $250,000 in cash or its equivalent; and
4. Be able to keep and perform its contracts.

The grounds for revoking a company's certificate of authority would, therefore, primarily turn on issues of financial capacity and stability as well as its record of faithful performance on its contracts. We would, of course, be concerned if we obtained credible evidence that either a company's officers or controlling stockholders had a past involvement in insurance or other corporate fraud. If this were the case, we feel we would have reasonable grounds to infer a potential danger to the financial stability of the insurance company we were examining.

*Keep Freedom in Your Future With U.S. Savings Bonds*

We have contacted the Justice Department's Organized Crime and Racketeering Section on the broader issue whether some other federal statute permits debarment of a federal contractor based solely on credible evidence that the business is owned or controlled by organized crime figures. I am sure you will be interested to learn that they are not aware of any such statute.

Recently my legal counsel and members of the Bureau's Audit Staff met with Mr. Paul Boucher, Small Business Administration's Inspector General, to seek information concerning the basis for the allegations made against International Fidelity Insurance Company. We plan to continue our contact with Mr. Boucher's office in order to obtain further information from the files they have compiled as a result of some far ranging investigations. Obviously, I am not in a position at this time to tell you what the results of this coordinated activity may be. Moreover, I am sure you realize that should we receive evidence against any insurance company which, in our view, would support possible revocation action consistent with the statutes governing this area, we would have to offer that company an opportunity to present rebuttal information in order to assure that due process is not violated.

We do not have the underlying evidence supporting the allegations made before the Select Committee. However, 18 U.S.C. 1962 makes unlawful the use of income derived from "racketeering activity" to acquire an interest in an enterprise affecting interstate commerce. Criminal penalties including forfeiture of the unlawfully acquired interest, and civil penalties including compelled divestiture of the unlawfully acquired interest, are available in enforcement actions which the Attorney General is authorized to bring. 18 U.S.C. 1963, 1964. Either penalty could create a situation in which the financial condition of a surety company unlawfully acquired was threatened. Thus, if the allegations and the supporting evidence were referred to the Attorney General, it could eventually result in creating circumstances in which revocation of the surety company's authority would be clearly warranted. Whether the Department of Justice should pursue such an avenue is, of course, a matter outside this Department's jurisdiction.

Again, thank you for bringing this information to our attention.

Sincerely,

W. E. Douglas

W. E. Douglas

Exhibit IVd

GAYLORD NELSON, WIS., CHAIRMAN
SAM NUNN, GA.
JOHN C. CULVER, IOWA
WALTER D. HUDDLESTON, KY.
DALE BUMPERS, ARK.
ROBERT MORGAN, N.C.
JAMES R. SASSER, TENN.
DONALD W. STEWART, ALA.
MAX BAUCUS, MONT.
CARL LEVIN, MICH.
LOWELL P. WEICKER, JR., CONN.
BOB PACKWOOD, OREG.
ORRIN G. HATCH, UTAH
S. I. HAYAKAWA, CALIF.
HARRISON H. SCHMITT, N.M.
RUDY BOSCHWITZ, MINN.
LARRY PRESSLER, S. DAK.
WILLIAM B. CHERKASKY, EXECUTIVE DIRECTOR
HERBERT L. SPIRA, CHIEF COUNSEL
ROBERT J. DOTCHIN, MINORITY STAFF DIRECTOR

United States Senate
SELECT COMMITTEE ON SMALL BUSINESS
WASHINGTON, D.C. 20510

September 25, 1980

Commissioner W. E. Douglas
Fiscal Service
Bureau of Government Financial
Operation
Department of The Treasury
Pennsylvania Avenue and Madison Place
Washington, D. C. 20226

RE: International Fidelity Insurance
33 Washington Street
Newark, New Jersey 07102

Dear Commissioner Douglas:

Today the Senate Select Committee on Small Business received testimony from the Small Business Administration's Inspector General, Paul Boucher, in which it was revealed that during the course of an investigation by his office, it was discovered that as of August, 1980, approximately 48% of International Fidelity Insurance Company stock is owned by known organized crime figures or associates thereof, or by companies partially controlled by such individuals.

This insurance company is currently listed by the Department of Treasury as a surety company acceptable on Federal bonds.

Based upon the testimony presented at our hearing, I request that you immediately remove the International Fidelity Insurance Company from your list of surety companies acceptable on Federal bonds until further review by your Agency.

I further request that you immediately commence a full-scale investigation to determine how effective your procedures and guidelines are for certifying companies on this list. I would also expect that based upon what SBA's Inspector General found in one company, you should reexamine each company on the list to determine the validity for the company's certification.

Sincerely,

Lowell Weicker, Jr.
United States Senator

LW:rmh

I would appreciate a verbal response by Monday next LW

Exhibit IVe

GEORGE R. ARIYOSHI
GOVERNOR

MARY G. F. BITTERMAN
DIRECTOR
INSURANCE COMMISSIONER

STATE OF HAWAII
INSURANCE DIVISION
DEPARTMENT OF REGULATORY AGENCIES
P. O. BOX 3614
HONOLULU, HAWAII 96811

February 16, 1982

The Honorable Lowell Weicker, Jr.
Chairman, Committee on Small Business
United States Senate
Washington, D. C. 20510

Dear Senator Weicker:

American Fidelity Fire Insurance Company (AFFI)

Your letter of February 6, 1982 to Commissioner Bitterman has been referred to me for reply.

On April 26, 1978, American Fidelity Fire Insurance Company's admission application to Hawaii was rejected because of the adverse test results reported in the National Association of Insurance Commissioners' (NAIC) Early Warning System.

Our major concerns were in loss reserves and reinsurance areas.

We hope this information will be helpful in your deliberation.

Yours truly,

CLIFFORD J. MIYOI
Acting Assistant Insurance Commissioner

Exhibit IVf

The Commonwealth of Massachusetts
Division of Insurance
100 Cambridge Street, Boston 02202

MICHAEL J. SABBAGH
COMMISSIONER OF INSURANCE

February 23, 1982

Lowell Weiker, Jr.
Chariman, Committee on Small Business
United State Senate
Washington, D.C. 20510

Dear Senator Weicker:

This will acknowledge your letter of February 6, 1982 regarding American Fidelity Fire Insurance Company.

American Fidelity Fire Insurance has not been allowed to transact business in Massachusetts since September 6, 1978, due to its financial condition, operating results and failure to make timely filings.

I have attached a copy of a letter dated September 6, 1978 and American Fidelity Fire Insurance Company's response dated October 6, 1978.

Very truly yours,

Michael J. Sabbagh
Commissioner of Insurance

MJS:mec
ENC.

Exhibit IVg

OFFICE OF
COMPTROLLER GENERAL
STATE CAPITOL
ATLANTA, GEORGIA 30334

JOHNNIE L. CALDWELL
COMPTROLLER GENERAL

February 11, 1982

The Honorable Lowell Weicker, Jr., Chairman
Committee on Small Business
The United States Senate
Washington, D. C. 20510

Dear Senator Weicker:

Re: American Fidelity Fire Insurance Company (AFFI)

Reference is made to your February 6, 1982 letter regarding information on AFFI.

For several years dating as far back as 1967, this Department was concerned over the continued unfavorable underwriting experience of this company. Because of the continuing deterioration of AFFI's operation and to protect the interest of the policyholders of this State, on September 9, 1976 I requested that the company voluntarily cease and desist writing any new and renewal business in the State of Georgia.

I received a request in April, 1977 to permit AFFI to re-enter the market in Georgia for SBA Bonds only. I determined the need for this market in Georgia; and, after looking at the company's financial condition, in order to preserve the ability of the company to pay claims if and when they arose, I authorized the company to resume operation in Georgia from April 25, 1977 to December 31, 1977 under the following conditions:

(1) No single SBA Bond to exceed $75,000.

(2) Annual premiums for Small Business Authority Bonds not to exceed $500,000.

(3) No SBA Bond to be written until such time as eligible deposits for the benefit of Georgia policyholders only totals $250,000. As of this time, American Fidelity Fire Insurance Company has on deposit with the Security Deposit Division of the State of Georgia $125,000.

(4) This authority shall expire as of midnight, December 31, 1977 unless revoked sooner by this Department. The writings are to be restricted to Norton Insurance Associates only.

(5) A resolution from American Fidelity Fire Insurance Company's Board of Directors agreeing to terms and conditions as stipulated in this letter.

This authority was subsequently extended through June 30, 1978.

In April, 1981, the President of AFFI, Mr. Luther Williams, requested permission to resume unrestricted operations in Georgia. The company had not posted an underwriting profit during the period 1976-80. In each of these years, the company's operating ratio exceeded 100 percent. The National Association of Insurance Commissioners' (NAIC) Insurance Regulatory Information System (IRIS) advised that the company had five ratios outside the usual range based on its 1980 annual statement; and was therefore classified as a company requiring special attention. For these reasons, Mr. Williams' request was denied.

Until such time as I am assured that further transactions by this company are no longer hazardous to the policyholders of Georgia, I will not authorize the company to resume active operation in this State.

My staff and I stand ready to assist you or members of your committee whenever possible.

Sincerely,

Johnnie L. Caldwell
Insurance Commissioner

JLC:dj

Exhibit V

## CLASSIFICATION OF BUSINESS

**Written and Ratio of Losses Incurred (Including Adjusting Expenses) to Premiums Earned—Premiums in thousands (000 omitted)**

AN EXCESS INS. CO.
ERTY PLAZA, 91 LIBERTY ST.
RK, NY 10006  TEL  212-766-6700

D IN CA,CT,DE,NY.

| | | |
|---|---|---|
| ACTICE | 109 | 72.5 |
| RS COMPENSATION | 1,772 | 73.4 |
| ILITY, NOT AUTO | 6,934 | 76.5 |
| LIABILITY, P.P. | 4 | |
| LIABILITY, COMMERCIAL | 2,886 | 67.6 |
| TOTAL | 11,705 | 73.8 |

AN FAMILY HOME
BOX 85323
NATI, OH 45201  TEL  513-721-3777

ED IN AL,AK,AZ,DE,FL,GA,IN,IA,MS,MO,MT,OH,OK,SC,SD,UT,

| | | |
|---|---|---|
| | 206 | 94.4 |
| ED LINES | 103 | |
| OWNERS | 324 | 255.1 |
| ND MARINE | 62 | 50.1 |
| ILITY, NOT AUTO | 695 | 24.2 |
| PHYSICAL DAMAGE, P.P. | 11,456 | 61.1 |
| TOTAL | 12,867 | 62.5 |

AN FAMILY MUTUAL
BOX 7430
N, WI 53783  TEL  608-249-2111

ED IN CA,CO,IL,IN,IA,KS,MI,MN,MO,NE,ND,SD,WI.

| | | |
|---|---|---|
| | 3,724 | 54.0 |
| IED LINES | 2,595 | 67.7 |
| OWNERS | 6,420 | 92.1 |
| OWNERS | 96,445 | 87.4 |
| ERCIAL MULTI PERIL | 8,318 | 66.2 |
| AND MARINE | 3,110 | 58.4 |
| AL HEALTH | 57,367 | 76.3 |
| ERS' COMPENSATION | 2,576 | 63.0 |
| BILITY, NOT AUTO | 2,807 | 59.3 |
| O LIABILITY, P.P. | 172,776 | 73.6 |
| O LIABILITY, COMMERCIAL | 4,950 | 47.1 |
| O PHYSICAL DAMAGE, P.P. | 141,220 | 77.1 |
| O PHYSICAL DAMAGE, COMMERCIAL | 5,342 | 113.5 |
| ELITY | 1 | |
| SS | 3 | 66.7 |
| GLARY AND THEFT | 19 | 41.7 |
| NSURANCE | 852 | 378.8- |
| TOTAL | 508,514 | 74.6 |

FARMERS MUT. CAS.
BOX 3755, URBANDALE STATION
OINES, IA 50322  TEL  515-278-4621

NSED IN IA.

| | | |
|---|---|---|
| EOWNERS | | |
| AND MARINE | | |
| ABILITY, NOT AUTO | | |
| TO LIABILITY, P.P. | 381 | 61.1 |
| TO PHYSICAL DAMAGE, P.P. | 471 | 66.2 |
| TOTAL | 852 | 63.8 |

ICAN FELLOWSHIP MUTUAL
W. GRAND BLVD.
OIT, MI 48208  TEL  313-875-8300

NSED IN MI.

| | | |
|---|---|---|
| IRE | 4 | 406.4 |
| OWNERS | 14 | 902.5 |
| LIABILITY, P.P. | 2,145 | 103.6 |
| LIABILITY, COMMERCIAL | 29 | 53.6 |
| PHYSICAL DAMAGE, P.P. | 3,328 | 55.4 |
| PHYSICAL DAMAGE, COMMERCIAL | 25 | 40.7 |
| TOTAL | 5,545 | 74.7 |

ICAN FIDELITY CO.
O BOX
CHESTER, NH 03104  TEL  603-669-6300

NSED IN AK,CT,DE,DC,IA,ME,MD,MA,MS,NE,NH,ND,OK,OR,RI,SC,
VT,VA,WV.

AMERICAN FIDELITY FIRE
100 CROSSWAYS PARK WEST
WOODBURY, NY 11797  TEL  516-364-2700

LICENSED IN DC & ALL STATES EXCEPT CO,HI,ME,NH.

| | | |
|---|---|---|
| FIRE | 2- | 185.5- |
| ALLIED LINES | 6- | 64.6 |
| HOMEOWNERS | | 626.1- |
| COMMERCIAL MULTI PERIL | 1,177 | 51.5 |
| OCEAN MARINE | | |
| INLAND MARINE | 101 | 67.1 |
| WORKERS COMPENSATION | 9- | 213.9 |
| LIABILITY, NOT AUTO | 12- | 567.9 |
| AUTO LIABILITY, P.P. | 2,404 | 113.7 |
| AUTO LIABILITY, COMMERCIAL | | |
| AUTO PHYSICAL DAMAGE, P.P. | 1,025 | 150.2 |
| AUTO PHYSICAL DAMAGE, COMMERCIAL | 467 | 120.7 |
| AIRCRAFT ALL PERILS | | 836.0 |
| FIDELITY | 64 | 7.7- |
| SURETY | 5,588 | 61.7 |
| GLASS | | |
| BURGLARY AND THEFT | 29 | 8.5- |
| REINSURANCE | 3 | 204.2- |
| MISCELLANEOUS | | 1.6 |
| TOTAL | 10,769 | 87.9 |

AMERICAN FIRE & CAS.
136 N. THIRD ST.
HAMILTON, OH 45012  TEL  513-867-3000

LICENSED IN DC AND ALL STATES EXCEPT AK,CT,HI,ID,ME,MA,MI,
MN,MT,NV,NH,NJ,NM,NY,ND,RI,SD,VT,WA,WV,WY.

| | | |
|---|---|---|
| FIRE | 1,235 | 52.7 |
| ALLIED LINES | 569 | 31.3 |
| HOMEOWNERS | 3,464 | 67.0 |
| COMMERCIAL MULTI PERIL | 716 | 29.7 |
| INLAND MARINE | 496 | 69.4 |
| MALPRACTICE | | |
| EARTHQUAKE | 1 | |
| TOTAL HEALTH | 96 | 81.4 |
| WORKERS COMPENSATION | 882 | 91.5 |
| LIABILITY, NOT AUTO | 1,156 | 45.3 |
| AUTO LIABILITY, P.P. | 4,746 | 64.8 |
| AUTO LIABILITY, COMMERCIAL | 778 | 59.1 |
| AUTO PHYSICAL DAMAGE, P.P. | 2,315 | 84.6 |
| AUTO PHYSICAL DAMAGE, COMMERCIAL | 415 | 38.2 |
| FIDELITY | 458 | .5 |
| SURETY | 680 | 19.0 |
| GLASS | 9 | 100.0 |
| BURGLARY AND THEFT | 53 | 75.6 |
| MISCELLANEOUS | | |
| TOTAL | 18,073 | 60.9 |

AMERICAN FIRE & INDEMNITY
P. O. BOX 1259
GALVESTON, TX 77553  TEL  713-766-4600

LICENSED IN AL,AZ,AR,CO,FL,GA,IL,IN,KS,KY,LA,MS,MO,NM,OH,OK,
TN,TX,WI.

| | | |
|---|---|---|
| FIRE | 565 | 65.3 |
| ALLIED LINES | 681 | 67.9 |
| FARMOWNERS | 53 | 188.5 |
| HOMEOWNERS | 5,768 | 66.1 |
| COMMERCIAL MULTI PERIL | 196 | 110.3 |
| INLAND MARINE | 106 | 58.1 |
| LIABILITY, NOT AUTO | 2 | |
| AUTO LIABILITY, P.P. | | |
| AUTO LIABILITY, COMMERCIAL | | |
| BURGLARY AND THEFT | 1 | |
| TOTAL | 7,370 | 67.2 |

BALBOA INS. CO.
P. O. BOX 1770
NEWPORT BEACH, CA 92663 TEL 714-644-8260

LICENSED IN DC AND ALL STATES EXCEPT LA. ALSO IN CN,GUAM, VI.

| | | |
|---|---|---|
| FIRE | 3,339 | 20.6 |
| ALLIED LINES | 658 | 25.0 |
| HOMEOWNERS | 8,928 | 56.3 |
| COMMERCIAL MULTI PERIL | 1,879 | 92.1 |
| INLAND MARINE | 6,649 | 20.7 |
| TOTAL HEALTH | 5,863 | 71.5 |
| WORKERS COMPENSATION | | |
| LIABILITY, NOT AUTO | 69 | 24.9 |
| AUTO LIABILITY, P.P. | 7,484 | 51.6 |
| AUTO PHYSICAL DAMAGE, P.P. | 36,537 | 46.9 |
| FIDELITY | 599 | 54.6 |
| SURETY | 5,936 | 4.5 |
| TOTAL | 77,941 | 44.6 |

BALDWIN MUTUAL INS. CO.
BOX 610-210 W. LAUREL AVE.
FOLEY, AL 36535

LICENSED IN AL.

| | | |
|---|---|---|
| FIRE | 2,282 | 50.7 |
| ALLIED LINES | 498 | 64.9 |
| LIABILITY, NOT AUTO | 1 | |
| TOTAL | 2,781 | 53.6 |

BALOISE INS. OF AMERICA
6 WORLD TRADE CENTER
NEW YORK, NY 10048 TEL 212-775-1300

LICENSED IN LA,MI,NY.

| | | |
|---|---|---|
| FIRE | 15 | 94.1 |
| ALLIED LINES | 4 | 166.7 |
| COMMERCIAL MULTI PERIL | 408 | 77.6 |
| OCEAN MARINE | 800 | 62.6 |
| INLAND MARINE | 880 | 63.6 |
| AUTO PHYSICAL DAMAGE, P.P. | 31 | 22.6 |
| TOTAL | 2,138 | 65.5 |

BANKERS INSURANCE CO.
P. O. BOX 15707
ST. PETERSBURG, FL 33733 TEL 813-323-3000

LICENSED IN FL.

| | | |
|---|---|---|
| FIRE | 11 | 133.3 |
| ALLIED LINES | 25 | 16.0 |
| HOMEOWNERS | 203 | 10.2 |
| COMMERCIAL MULTI PERIL | 296 | 70.6 |
| INLAND MARINE | 390 | 19.6 |
| TOTAL HEALTH | 2 | |
| LIABILITY, NOT AUTO | 196 | 81.0 |
| AUTO LIABILITY, P.P. | 2,725 | 103.0 |
| AUTO LIABILITY, COMMERCIAL | 365 | 230.5 |
| AUTO PHYSICAL DAMAGE, P.P. | 1,862 | 88.8 |
| AUTO PHYSICAL DAMAGE, COMMERCIAL | 190 | 85.7 |
| SURETY | 270 | 1.1 |
| REINSURANCE | 72- | |
| MISCELLANEOUS | | |
| TOTAL | 6,404 | 89.9 |

BANKERS MULTIPLE LINE
810 N. KENNETH AVE.
CHICAGO, IL 60630 TEL 312-777-7000

ICENSED IN DC AND ALL STATES.

| | | |
|---|---|---|
| FIRE | 1 | 223.7- |
| ALLIED LINES | | |
| HOMEOWNERS | 8 | 309.0 |
| INLAND MARINE | | 673.3- |
| TOTAL HEALTH | 30,078 | 74.1 |
| LIABILITY, NOT AUTO | | |
| AUTO LIABILITY, P.P. | 9 | 875.8- |
| AUTO LIABILITY, COMMERCIAL | | |
| AUTO PHYSICAL DAMAGE, P.P. | 6 | 778.0- |
| FIDELITY | 11 | |
| SURETY | 25 | 334.8- |
| MISCELLANEOUS | | |
| TOTAL | 30,138 | 75.0 |

BANKERS MUTUAL INS.
1104 SPRING ST.
SILVER SPRING, MD 20910 TEL 301-565-2655

LICENSED IN DE,DC,IN,MD,OH.

| | | |
|---|---|---|
| FIRE | 300 | 21.3 |
| ALLIED LINES | 56 | 9.0 |
| INLAND MARINE | 664 | 38.8 |
| TOTAL HEALTH | 848 | 77.6 |
| AUTO PHYSICAL DAMAGE, P.P. | 1,830 | 73.3 |
| AUTO PHYSICAL DAMAGE, COMMERCIAL | 49 | 39.5 |
| BURGLARY AND THEFT | 249 | 12.7 |
| TOTAL | 3,998 | 59.4 |

BANKERS STANDARD F. & M.
1600 ARCH ST.
PHILADELPHIA, PA 19103 TEL 215-241-4000

LICENSED IN AL,CO,DE,DC,FL,GA,ID,IA,LA,MN,MS,MO,MT,NE,NM,OK, OR,SD,TN,TX,UT.

| | | |
|---|---|---|
| FIRE | 248 | 51.7 |
| ALLIED LINES | 262 | 121.5 |
| FARMOWNERS | 152 | 76.5 |
| HOMEOWNERS | 1,173 | 65.7 |
| COMMERCIAL MULTI PERIL | 3,229 | 48.4 |
| OCEAN MARINE | 993 | 81.1 |
| INLAND MARINE | 701 | 104.5 |
| MALPRACTICE | 192 | 63.6 |
| EARTHQUAKE | 10 | 3.8 |
| TOTAL HEALTH | 77 | 30.8 |
| WORKERS COMPENSATION | 3,999 | 71.3 |
| LIABILITY, NOT AUTO | 1,030 | 56.3 |
| AUTO LIABILITY, P.P. | 2,772 | 59.1 |
| AUTO PHYSICAL DAMAGE, P.P. | 655 | 68.5 |
| AIRCRAFT ALL PERILS | 133 | 77.9 |
| FIDELITY | 232 | 46.1 |
| SURETY | 176 | 23.2 |
| GLASS | 4 | 53.6 |
| BURGLARY AND THEFT | 69 | 27.9 |
| BOILER AND MACHINERY | | 20.1 |
| REINSURANCE | | 162.6- |
| MISCELLANEOUS | 8 | 122.1 |
| TOTAL | 16,116 | 64.0 |

BANKERS STANDARD INS.
1600 ARCH ST.
PHILADELPHIA, PA 19103 TEL 215-241-4000

LICENSED IN DC AND ALL STATES EXCEPT AK,HI,ME,NE,NH,RI,WV, WI,WY.

| | | |
|---|---|---|
| FIRE | 403 | 51.7 |
| ALLIED LINES | 425 | 121.5 |
| FARMOWNERS | 247 | 76.5 |
| HOMEOWNERS | 1,906 | 65.7 |
| COMMERCIAL MULTI PERIL | 5,246 | 48.4 |
| OCEAN MARINE | 1,613 | 81.1 |
| INLAND MARINE | 1,139 | 104.5 |
| MALPRACTICE | 312 | 63.6 |
| EARTHQUAKE | 16 | 3.8 |
| TOTAL HEALTH | 126 | 30.8 |
| WORKERS COMPENSATION | 6,499 | 71.3 |
| LIABILITY, NOT AUTO | 1,674 | 56.3 |
| AUTO LIABILITY, P.P. | 4,504 | 59.1 |
| AUTO PHYSICAL DAMAGE, P.P. | 1,065 | 68.5 |
| AIRCRAFT ALL PERILS | 217 | 77.9 |
| FIDELITY | 378 | 46.1 |
| SURETY | 285 | 23.2 |
| GLASS | 6 | 53.6 |
| BURGLARY AND THEFT | 112 | 27.9 |
| BOILER AND MACHINERY | 1 | 20.2 |
| REINSURANCE | 1 | 163.0- |
| MISCELLANEOUS | 13 | 122.1 |
| TOTAL | 26,188 | 64.0 |

BARNSTABLE CO. MUT. FIRE
P. O. BOX 8
YARMOUTH PORT, MA 02675 TEL 617-362-4567

LICENSED IN MA.

| | | |
|---|---|---|
| FIRE | 400 | 18.7 |
| ALLIED LINES | 158 | 23.2 |
| HOMEOWNERS | 4,121 | 32.2 |
| TOTAL | 4,679 | 30.7 |

Exhibit VI

JAN 15 [illegible]

[REGISTERED MAIL]

Mr. Arthur Bernstein and
Mr. Marvin B. Uritz
c/o Market Insurance Corporation
15910 Ventura Boulevard
Encino, California 91436

Gentlemen:

For some time Market Insurance Corporation ("Market") has been active as a managing agency of agents producing surety bonds under the Surety Bond Guarantee Program of the Small Business Administration. According to our records, Market also has submitted in its own name applications for SBA's surety bond guarantee. It is our understanding that you are principals of Market Insurance.

The results of certain recent litigation involving you have been brought to our attention. As we understand the matter, the litigation arose in connection with an application made by you to the Department of Insurance, State of California, for a particular license, which application ultimately was denied by the California Department of Insurance ("Department"). As we further understand it, you brought suit against the Department, following its denial action, and petitioned a court to require the Department to issue the license applied for. The contents of the decision of the court hearing the matter causes us great concern in view of the necessity for a high degree of trust in a surety agent, and in its managing agent, in order to properly protect the interest of the Government as guarantor of surety bonds brought to SBA by an agent, managing agency, or surety.

Sec. 115.3 of the Regulations of the Small Business Administration (13 CFR) provides for the refusal to issue further guarantees upon, among other things, the knowledge of acts of wrongdoing on the part of a surety, or agent (a person included in the definition of a "surety" by the Small Business Investment Company Act, as amended).

In light of the finding August 20, 1981, by the Superior Court of California, County of Los Angeles, of wrongdoing by you in your operation of Market Insurance Corporation, and the further finding of unsatisfactory conduct by you in the operation of Market, we hereby notify you that commencing thirty (30) days from the date of this letter this Agency will issue no surety bond guarantees to a surety where the bond is written by or through any agent obligated by agreement or otherwise to pay any bond commission to you or any person affiliated with you, unless you within 30 days following this letter can show to the satisfaction of SBA why the action planned should not be implemented.

Our action is based upon the following particular findings of the California court, as such findings are reproduced below in relevant part, beginning at paragraph 14:

"d. Bernstein and Uritz are licensees of the Dept. of Insurance, and are the principals of Market Insurance Corporation ('Market'), a licensee of the Department of Insurance. Market is managed by Bernstein and Uritz.

"e. In conjunction with a new application for surplus line and special line surplus lines brokers license submitted by Market, the Department of Insurance conducted an extensive examination and audit of Market and its activities. Said examination and audit required several weeks to complete. The Department of Insurance discovered that Bernstein and Uritz in their operation of Market, failed to properly maintain fiduciary funds in the manner required by law, to wit:

"(1) Market did not maintain sufficient funds in a California trustee bank account or depository to cover all premiums and return premiums net of commissions, collected on California business and unpaid to the person entitled thereto;

"(2) Market did not maintain fiduciary funds on California business in a separate California trustee bank account or depository but instead commingled these fiduciary funds with premiums received on insurance business written in other states; and

"(3) Market diverted fiduciary funds received on California business to its own use. Such funds were diverted in the form of deposits which were not designated as trust accounts, but were instead invested by Market in municipal bonds and repurchase securities.

"f. The Department's examination further disclosed that Bernstein and Uritz, through Market, issued binders for automobile insurance on behalf of three identified insurers, collected premiums thereon, and then cancelled or declined issuance of the insurance; however, they never reported either the issuance of such binders or their cancellation or declination of coverage or the premiums earned thereon to the respective insurers. Aggregate gross premiums totalled $51,953.96; net premiums equaled $34,982.87. Although an accounts payable liability apparently was established for the insurers involved, there is no evidence that any premiums earned thereon have ever been remitted or reported to the three carriers involved nor have such earned premiums ever been declared by such carriers for imposition of California premium taxes thereon.

"g. In three specific instances where the Insurance Commissioner ('the Commissioner') has been appointed the conservator and/or liquidator of an insolvent insurer, the Commissioner has been compelled to litigate with Bernstein and/or Market to collect monies owing to the estate of the insolvent insurer. In a fourth instance, the Commissioner, as liquidator of an insolvent insurer, will be again compelled to institute a lawsuit against Market to collect monies on behalf of the estate of the insolvent insurer.

"h. As a result of the aforementioned conduct of Bernstein and Uritz, the proponents of ABC, the Commissioner can make none of the findings required by section 839 of the Insurance Code. Consequently, petitioners' applications for organizational security permits are required to be denied.

"i. Bernstein and Uritz, the proponents of ABC, are materially deficient in respect to the subjects set forth in Insurance Code section 717(e), (h), and (i). Said material deficiencies are sufficient to warrant the denial of any certificate of authority to ABC to act as attorney-in-fact for an interinsurance exchange.

"j. Neither Bernstein nor Uritz, by virtue of their conduct in the management of Market, together with other examples, display the character, competency, or integrity necessary and sufficient to manage and operate a licensed exchange as the attorney-in-fact thereof within the purview and requirements of both Insurance Code §§ 717 and 839.

* * * * *

Recognition is made of the existence of notice of your intent to appeal the August 21, 1981, decision of the Superior Court of California, County of Los Angeles. Should you not demonstrate, within the 30 days following, good cause for this Agency to reconsider its position, SBA nevertheless will reconsider its position in the event you proceed with the appeal of the above-referenced court decision and any such appeal decision is favorable to you.

We regret that our action has become necessary, but this Agency has no alternative in the circumstances.

Sincerely,

(signed) Arthur E. Armstrong

Arthur E. Armstrong
Director
Office of Special Guarantees

OSG:SLHARBOUR(235-2905):bgl:1/12/82

cc: Mr. Armstrong
Mr. Lineberry/Holloway
Mr. Huegel
Mr. Harbour
Mr. Braswell
✓IG

Subject File
SBG File
Ms. Waugh
Central Files
OSG Chron

Exhibit VII

July 24, 1978

Miller & Daar
Attorneys at Law
Suite 720 - Wilshire Doheney Plaza
East Tower
9100 Wilshire Boulevard
Beverly Hills, CA 90212

ATTENTION: Harry O. Miller

SUBJECT: American Business Corporation - Pending Application for Organizational Permit No. SF 1242
American Business Corporation - Attorney-in-fact for American Business Insurance Exchange - Pending Application for Organizational Permit No. SF 1243
American Business Insurance Exchange - Pending Application for Securities Permit No. SF 1244
Market Insurance Corporation - Marvin D. Uritz and Arthur Bernstein
DENIED

Gentlemen:

The above-captioned applications for Organizational Security Permits were formally filed with this Department on August 26, 1977, and have remained pending since that date. Permit No. SF 1242 is designed to fund American Business Corporation, the proposed attorney-in-fact for a new exchange in process of formation. Permits Nos. SF 1243 and 1244 relate to the organization and funding of the proposed exchange so that the exchange may be eligible to apply for and receive a certificate of authority authorizing the transaction of the class of liability insurance in California. These applications in totality relate to the creation, organization and funding of a reciprocal designed primarily to provide a dram shop liability insurance coverage to restauranteurs, tavern owners and liquor store operators.

The attorney-in-fact is designed to be funded in the amount of $100,000 through the sale of 5000 shares at $50,000 to Barry Bernstein and an additional 5000 shares at $50,000 to the Marvin D. Uritz Children Trust. Funds underwriting this sale will come either from Mr. Bernstein and Mr. Uritz personally or from the Market Insurance Corporation, a present licensee of this Department. Mr. Uritz is designated as Chairman of the Board, president and director of the proposed attorney-in-fact; Mr. Arthur Bernstein is designated as its Secretary-Treasurer and Director; and Mr. Barry Bernstein is designated as a Director of said attorney-in-fact.

As you know, California Insurance Code §839 requires the Insurance Commissioner to issue his Security Permit only if he finds that:

(a) The proposed plan of buisness of the applicant and the proposed issuance of securities are fair, just and equitable;

(b) The Applicant intends fairly and honestly to transact its business; and

(c) The securities the Applicant proposes to issue and the methods to be used by it in issuing or disposing of them are such as, in his opinion, will not work a fraud upon the purchaser thereof, or upon policyholders or other security holder of Applicant.

Otherwise, he shall deny the application and notify the Applicant in writing of his decision. Additionally, the Insurance Code §717 prescribes that before granting a certificate of authority to any Applicant, the Commissioner shall consider the qualifications of said Applicant in respect to the following subjects: ... (e) Competency, character and integrity of management; ... (h) fairness and honesty of methods of doing business; and ... (j) hazard to policyholders or creditors, among other factors. Upon consideration of all relevant qualifications the Commissioner will issue a certificate of authority to such Applicant, unless the Commissioner shall have made a finding or findings, that the applicant is materially deficient in respect to one or more of the items outlined in (a) through (j) of said §717.

The findings of this Department are that neither Mr. Arthur Bernstein nor Mr. Marvin D. Uritz, perforce of their conduct in the management of Market Insurance Corporation, a Department licensee, together with other examples, display the character, competency, or integrity necessary and sufficient to manage and operate a licensed exchange as the attorney-in-fact thereof within the perview and requirements of both Insurance Code §§717 and 839. To the contrary, it is the finding of this Department that both Mr. Arthur Bernstein and Mr. Marvin D. Urtiz by their past conduct reveal marked deficiencies in these areas, delineated as follows:

(1) During the course of the conservation and liquidation of Cosmopolitan Insurance Exchange and Cosmopolitan Underwriters, Inc., then Insurance Commissioner Richard S. L. Roddis was compelled

to institute suit as conservator of the Exchange and the attorney-in-fact against Arthur Bernstein, individually and dba Commerce Insurance Service (Case No. 830149 - Los Angeles Superior Court). A stipulated judgment was entered in favor of Commissioner Roddis and against Arthur Bernstein and Commerce Insurance Service in the amount of $15,000 subject to the proviso that if defendant paid on account of said judgment an aggregate sum of $12,500 in installments at stipulated intervals, then said judgment would be deemed fully satisfied. We understand that Mr. Bernstein paid installments upon the judgment until the total of $7,300 was paid leaving an unpaid balance of $5,200. At that time attorneys for Mr. Bernstein and the Exchange settled for $3,900 cash to close off the matter. However, the saliant point is that the California Insurance Commissioner in his role as conservator was compelled to litigate for monies due and owing the Exchange and/or its attorney-in-fact.

(2) Then Insurance Commissioner Richard S. L. Roddis as Liquidator of Tower Indemnity Company, was also compelled to sue Arthur Bernstein dba Commerce Insurance Service (Case No. 830148 - Los Angeles Superior Court) and entered into a stipulated judgment in the amount of $10,000, subject to stipulation that if the sum of $8,500 was paid in installments on specific dates, then said payments would be deemed full satisfaction of thisjudgement. While the subject judgment was apparently paid pursuant to specified stipulation, nevertheless the saliant point remains that Commissioner Roddis in his role as liquidator of Tower Indemnity Company was also compelled to litigate for the payment of monies from Arthur Bernstein owing to the estate of the insurer in such liquidation.

(3) On December 29, 1976, Insurance Commissioner Wesley J. Kinder, liquidator of Westgate-California Insurance Company, filed his verified application in the liquidation proceedings for order to show cause why Market Insurance Corporation shouldnot pay monies owing to the liquidator. It was alleged that Market was the agent of Westgate-California and, by way of said application, the Insurance Commissioner as liquidator sought to collect monies owed by Market Insurance Corporation to Westgate-California pursuant to the terms and conditions of four separate written retrospective agreements. Although the subject application apparently has been demurred out of the liquidation proceedings thereby compelling the liquidator to file his separate action for these monies, it is our understanding that such suit either has been or shortly will be formally filed throughthe Office of the Attorney General. Here again the pattern is repeated that the Insurance Commissioner as liquidator of an insolvent insurer is compelled to legal action to obtain performanceof these outstanding retrospective agreements with Market Insurance Corporation.

(4) We understand that California Insurance Commissioner Wesley J. Kinder, as liquidator of Summit Insurance Company of New York, stands ready to file his application for order to show cause why Market Insurance Corporation should not pay monies owing to the liquidator arising out of buisness placed through Market Insurance Corporation with Summit Insurance Company of New York. The application requests an order or judgment in the amount of $235,144 and to make an accounting of premiums in the hands of Market. It is our further understanding that the Liquidator and counsel for Market Insurance Corporation are still negotiating settlement in respect of the disposition of this matter and for such reasons this particular law suit had not yet been formally filed. Again, however, the established policy is going to be followed; that is, the Liquidator will either compromise or be compelled to litigate with Market Insurance Corporation if it is to receive any of the premium monies held thereby, short of a negotiated settlement.

(5) In conjunction with a new application for surplus line and special line surplus lines brokers license submitted by Market Insurance Brokerage Corporation, the principals which are Arthur Bernstein and Marvin D. Uritz, our Investigation Division set upon an extensive examination of the Licensee and its activities. The Investigation report indicates that an audit, commencing with a field call to the subject office on January 31, 1978, and requiring several weeks to complete, revealed violations with respect to the handling of fiduciary funds as follows:

(a) Market Insurance Corporation did not maintain sufficient funds in a California trustee bank account or depository to cover all premiums and return premiums net of commissions, collected on California business and unpaid to the person entitled thereto;

(b) Market Insurance Corporation did not maintain fiduciary funds on California business in a separate California trustee bank account or depository but instead commingled these fiduciary funds with premiums received on insurance business written in other states; and

(c) Market Insurance Corporation diverted fiduciary funds received on California business to its own use in the form of deposits which were not designated as trust accounts and in the form of investments in municipal bonds and repurchase securities.

This investigation disclosed further that Market Insurance Corporation issued binders for automobile insuance on behalf of three identified insurers, collected premiums thereon, and cancelled or declined issuance of the insurance; however, it never reported either the issuance of such binders or their cancellation or declination of coverage or the premiums earned thereon to the respective insurers. Aggregate gross premiums totalled $51,953.96; net premiums equaled $34,982.87. Although an accounts payable liability apparently has been established for the insurers involved, there is no evidence that any premiums earned thereon have ever been remitted or reported to the three carriers involved nor have such earned premiums ever been declared by such carriers for imposition of California premium taxes thereon.

Under the current state of the record it is the finding of the Insurance Commissioner that the evidence of past conduct of the proponents of American Business Corporation demonstrates that none of the standards imposed under Insurance Code §839 are achieved and that the subject applications therefore are hereby are DENIED. In similar fashion the Insurance Commissioner finds material deficiencies in said proponents within the perview of Insurance Code §717(e),(h) and (j), which material deficiencies are sufficient to warrant the denial of any certificate of authority to American Business Corporation to act at attorney-in-fact for an interinsurance exchange.

Very truly yours,

WESLEY J. KINDER
Insurance Commissioner

By

JOHN J. FABER
Asst. Chief
Legal Division
(415) 557-3848

JJF:jc

cc: Wesley J. Kinder
Insurance Commissioner

Robert H. Cook
Supervising Insurance Examiner
Surveillance Analysis Division
Los Angeles Office

Edward J. Germann, Chief
Surveillance Analysis Division
Los Angeles Office

Dirk Hampton
Insurance Examiner
Surveillance A lysis Division

Exhibit VIII

December 8, 1981

Norma M. Nelson, Claims Supervisor
Surety Bond Guarantee Branch

Howard F. Huegel, Chief
Surety Bond Guarantee Branch

Exorbitant Legal Expenses

Paul has conveyed information from Dick Burns (Region IX) that the law firm of Lanak and Hanna (used by Balboa) is raising its charges to SBA to $80.00 an hour plus costs. (As an aside, Burns noted that this is the firm where Stan Haren, formerly an AFFI attorney, went to work.) This will mean, of course, an increase in the cost to SBA of Balboa's defense and settlement of claims arising from SBA surety bond guarantee defaults.

In a time of inflation and generally increasing costs, the increase noted by Burns is not surprising. Balboa and its attorney charges, however, are not presently causing concern, given its low (4.5) loss ratio. The total amount expended by AFFI for attorney fees, on the other hand, is a matter of great concern to me, and requires our immediate attention. With a loss ratio of 61.7, third highest among the ten most active participating sureties, we should ask pointed questions about AFFI's judgment in default situations.

Under the circumstances, questions which seem appropriate to ask immediately are:

1. Who in AFFI/UIP makes the initial investigatory report of the project status? Is there one firm being used, or are local firms used?

2. Who reviews the investigation report and determines whether to complete or pay the penal sum?

3. What are the qualifications of the person(s) who makes the decision to complete or pay the penal sum?

4. What factors constitute the decision of the person in item 3?

5. Under what conditions would a decision be made not to complete, but to pay the penal sum and "walk away?"

6. At what point does AFFI go against available collateral: cash, property, indemnitors?

Numerous cases can be cited which seem to illustratte questionable decisions to complete a job rather than pay the penal sum of the bond and "walk away." In at least 98% of defaults, AFFI opts to complete the job. Thereafter, the cases seem to escalate to two or three times the amount of the bond. At least one-third or more of this amount is incurred for legal expenses. Recently, I noticed two cases with bond amounts of about $221,000 which have both escalated to over $700,000. On one of these cases (Framing Systems) I asked Paul to have an assistant tally the total amount paid by AFFI to specified payees on the bordereau (including the United Inspection Bureau (UIB); to get UIB to explain the role which these payees played in resolving the default; and to have UIB furnish copies of the itemized bills/vouchers presented for payment by each payee.

Since the problem of exorbitant legal expenses is most noticeably endemic with AFFI, SBG should not limit the present inquiry to Framing Systems cited above, but should take action to curtail such disproportionate losses with other AFFI cases. An in-depth analysis of several similar cases would also seem appropriate. Paul has suggested that External Audits be asked to look into Framing Systems charges. External Audits could also be asked to do the in-depth analysis of several similar cases.

Norma M. Nelson, Claims Supervisor
Surety Bond Guarantee Branch
Office of Special Guarantees

SBGB:NMNelson:cjc

cc: SBG Chron
N. Nelson
Diary

## APPENDIX

PETER AND RANGEL CONSTRUCTION SERVICES, INC.
2040 W. Main, Suite 311
Rapid City, South Dakota 57701

March 9, 1982

Honorable Senator Lowell Weiker, Jr.
Chairman, Small Business Committee
4242 Russell Senate Building
Washington, D.C. 20510

Dear Senator Weiker,

I understand that your committee is presently conducting hearings on the Small Business Administration Guarantee Bond Program. My firm participates in that program. It is our only source of bonding.

Today I received notification that due to budgetary restraints new bond limit formulas are being instituted by the Small Business Administration. These bond limit formulas reduce my bonding level to twenty percent of last years level; from $250,000 down to $50,000. This policy is being instituted at the beginning of the new bidding season. and could not have been more poorly timed.

Anyone familiar with the construction industry knows that the ability to provide a bond is essential in order to participate as a general contractor. In fact, all federally funded projects over $25,000 in value require bonding. In this locality the majority of the new projects are federally funded since the commercial market is virtually non-existent. The new SBA guidelines severely hinder my ability to compete. It is my honest opinion that unless the guidelines are relieved, my firm will not survive until next construction season.

Not only is this situation financially devastating, it is demoralizing to the will. How many more roadblocks can be thrust into the paths of small businesses trying to survive? I do not mean to editorialize, but you have to understand that no administrative salaries were paid last month in an effort to stay solvent for this new construction season. The level of self sacrifice is constantly escalating.

I encourage you to support additional funding for the Small Business Administration so that its programs can be returned to a useful and functioning level. Without small businesses where will the competition come from?

Sincerely,

Richard M. Rangel

Richard M. Rangel
President

LOWELL WEICKER, JR., CONN., CHAIRMAN

BOB PACKWOOD, OREG.
ORRIN G. HATCH, UTAH
* S. I. HAYAKAWA, CALIF.
RUDY BOSCHWITZ, MINN.
SLADE GORTON, WASH.
DON NICKLES, OKLA.
WARREN RUDMAN, N.H.
ALFONSE M. D'AMATO, N.Y.

SAM NUNN, GA.
WALTER D. HUDDLESTON, KY.
DALE BUMPERS, ARK.
JAMES R. SASSER, TENN.
MAX BAUCUS, MONT.
CARL LEVIN, MICH.
PAUL E. TSONGAS, MASS.
ALAN J. DIXON, ILL.

ROBERT J. DOTCHIN, STAFF DIRECTOR
R. MICHAEL HAYNES, CHIEF COUNSEL
ALAN L. CHVOTKIN, MINORITY CHIEF COUNSEL

United States Senate
COMMITTEE ON SMALL BUSINESS
WASHINGTON, D.C. 20510

February 22, 1982

Mr. Arthur Bernstein
Mr. Marvin Uritz
Market Insurance Corporation
15910 Ventura Boulevard
Encino, California 91436

Dear Messrs Bernstein and Uritz:

As you are aware, the Senate Committee on Small Business is conducting an oversight review of the Small Business Administration's Surety Bond Guarantee Program. The Committee has examined all facets of the Program.

In regard to Market Insurance Corporation, the Committee has learned of audit findings prepared by the SBA Inspector General and the New York Department of Insurance, which are critical of Market's underwriting and claims adjusting practices.

The Committee is also aware of the California Department of Insurance's investigative findings pertaining to Market's handling of premium funds.

These findings are of great concern to the Committee. On January 27, 1982, when Committee investigators met with Mr. Bernstein to discuss these and other matters, he refused to discuss these matters and refused the Committee access to underwriting and claims files.

As Chairman of the Committee, I request that you now provide copies of the following claims files to the Committee offices in Washington, D.C.

1. Builders United Construction Company. Bond numbers 04-446-2221945 and 04-446-2221850.

2. Western Environmental Landscape Company. Bond number 04-206-1338305.

3. Spight Landscape Contractors. Bond numbers 94-021-2219794; 04-021-2650003; and 04-021-2650004.

4. Mountain Enterprises, Incorporated. Bond numbers 04-714-1277732; 04-714-1277751; 04-714-1277759; and 04-714-1277773.

On March 11, 1982, the Committee will hold a hearing on the Surety Bond Guarantee Program. I request that you appear as a witness at the hearing on that date to respond to questions concerning the above matters.

Thank you for your attention to these requests. If there are any questions, please contact Marc Smolonsky of the Committee staff at (202) 224-3099.

Please mail correspondence to: The Senate Committee on Small Business, Room 424, Russell Senate Office Building, Washington, D.C. 20510.

Sincerely,

LOWELL WEICKER, Jr.
Chairman

LAW OFFICES OF
EISENHOWER, CARLSON, NEWLANDS, REHA, HENRIOT & QUINN

C. JOHN NEWLANDS
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March 2, 1982

Honorable Lowell Weicker, Jr.
Chairman
United States Senate Committee on
Small Business
424 Russell Senate Office Bldg.
Washington, D.C. 20510

Dear Senator Weicker, Jr.

Please be advised that the undersigned represents Market Insurance Corporation and has been requested to reply to your letter of February 22, 1982 addressed to Mr. Arthur Bernstein and Mr. Marvin Uritz.

Market Insurance Corporation (Market) has not been provided audit findings prepared by the Small Business Administration Inspector General or the New York Department of Insurance nor is Market aware of the information the Senate Committee on Small Business may have from the California Department of Insurance respecting investigative findings pertaining to the handling of premium funds.

Mr. Bernstein did meet with members of your Committee staff of the Committee on Small Business but was not aware that they were "investigators." Mr. Bernstein accepted a request of the Committee to meet with him under the impression that the staff wished to discuss the "Program" in general terms. Mr. Bernstein did not refuse to discuss matters with the Committee staff but did refer matters concerning claims handling to United Inspection Bureau and did refer litigation matters to the attorney responsible. Market does not have possession of the claim files referenced in your letter. Also, Market does not have possession of underwriting files on bonds written by general agents unless they are bonds written in excess of a general agent's authority. You should be advised that Mr. Bernstein was not asked for any underwriting files.

Although you have requested that Mr. Bernstein testify at a hearing scheduled by the Committee on March 11, 1982, it is my understanding from discussions with the General Counsel of the Committee that the Committee does not have sufficient time to hear Mr. Bernstein's testimony. The General Counsel suggested, and I agreed, that he will forward to me a copy of the hearing transcript. We have further agreed that the record will remain open for a sufficient amount of time to provide Market an opportunity to prepare a written reply to the testimony given at the hearing, which reply will be placed in the hearing record.

If you will take an opportunity to review the history of the relationship between the Senate Committee on Small Business and Market you will find that Market has been most cooperative in assisting the Committee, not only in simply attempting to educate the Committee staff into the nature of surety but also in providing technical assistance in drafting legislation. As members of the Committee staff have become educated to a degree into this program, and then either left the Committee or took different responsibilities on the Committee staff, Market's personnel have spent time with new staff members in attempting to explain surety and the premises upon which the Small Business Administration Surety Bond Guaranty Program is based.

Market understands that the Senate Committee on Small Business has oversight responsibility as respects the Small Business Administration. As in the past, Market is quite willing to cooperate with the Committee in exercising its oversight responsibility and in assisting to make the Surety Bond Guaranty Program better. However, in fairness to Market (or any other company), in the event the Committee comes into possession of information it considers critical of the business operation of Market, it would be appreciated if the Committee would advise Market of this information and allow Market an opportunity to explain itself in a normal course of business rather than to demand files without explanation or to place these criticisms on the public record through the Committee hearing process without first having provided Market an opportunity for explanation. In the event the Committee is not satisfied with Market's response, certainly the Committee would be entitled to take whatever further action it deems appropriate.

If the Committee would like to renew its request for the files listed in your letter of February 22, please advise. Also then please advise as to the Committee's reason for requesting said files and what the Committee intends to do with the information contained in those files. As stated, Market does not have possession of those files, but if the Committee's request is not unreasonable, Market will make efforts to obtain those files for the benefit of the Committee.

Very truly yours,

Richard D. Turner

RDT/cwp
cc: Arthur Bernstein
Michael Haines, General Counsel

LOWELL WEICKER, JR., CONN., CHAIRMAN
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United States Senate
COMMITTEE ON SMALL BUSINESS
WASHINGTON, D.C. 20510

March 12, 1982

Richard D. Turner
Eisenhower, Carlson, Newlands,
  Reha, Henriot & Quinn
1200 First Interstate Plaza
Tacoma, Washington 98402

Dear Mr. Turner:

This is in response to your letter of March 2, 1982, to Senator Weicker and our telephone conversation of March 9, 1982. Based upon your letter and our telephone conversation, there are a number of matters that I believe need to be clarified.

On January 18, 1982, I spoke with Mr. Bernstein on the telephone and requested that he meet with Marc Smolonsky and John McLean of the Committee staff. I advised him that Smolonsky was the Committee's investigator and that McLean was a professional staff member, working on this investigation with Smolonsky. Further, as part of the Committee's oversight function, I advised him that they had been investigating the SBA Surety Bond program for approximately four months. I further advised that during the course of this investigation a number of questions arose concerning both specific cases and the operating procedures of Market Insurance and United Inspection Bureau (UIB). I requested that Mr. Bernstein meet with them to answer their questions.

In response to Mr. Bernstein's specific inquiry, I further advised him that Smolonsky and McLean wanted to ask questions about the underwriting procedures of Market; the claims procedures of UIB; and the California Department of Insurance findings against Market. Furthermore, I informed Mr. Bernstein that based upon the Committee's investigation to date, and information critical of Market's and UIB's operations obtained from the SBA Inspector General, the questions asked of Mr. Bernstein might be "tough questions". In addition, I specifically informed him that we would want to examine specific claims files about which the Committee had some questions, and that Smolonsky and McLean planned to be in California the following week.

Mr. Bernstein responded that he would meet with Smolonsky and McLean, checked his calendar, stated that two of the days they were scheduled to be there were open, and said that he would keep these days free to meet with them to discuss these matters.

Although Smolonsky had placed telephone calls to Mr. Bernstein on January 13, 14 and 15, 1982, to arrange an interview at Market's office in Encino, California, none of those calls had been returned.

Smolonsky, accompanied by McLean, arrived at Bernstein's office on the morning of January 27. On January 26, Smolonsky called to confirm the appointment, but Bernstein did not return the call.

Smolonsky and McLean took notes of the January 27 meeting, and transcribed those notes into a detailed memorandum of interview. When the interview began, Smolonsky explained the scope of the Committee's investigation, noted that the Committee was examining AFFI, and as a result, Market and UIB, as well. Bernstein asked, "What do you want to know?"

Smolonsky began asking Bernstein about the California Department of Insurance Investigation. Bernstein replied, "I don't know about that. You tell me about it." As Smolonsky began outlining the Department's investigation, Bernstein said he wanted to defer all questions about this matter to his attorney, Barry Bernstein. Smolonsky and McLean met with Barry Bernstein later that day, and the attorney answered their questions.

Smolonsky then asked Bernstein about an antitrust suit, one of Market's former sub-agents had filed against the firm, and Bernstein also deferred that question to his attorney.

Bernstein was asked about Market's retrospective agreements with AFFI and the retrospective agreements Market had with its sub-agents. He replied, "It's none of your business. Get a copy from SBA. They have all that. It's none of the Senate's business."

Smolonsky asked Bernstein several more questions about Market's relationship with AFFI, to which Bernstein continually responded, "It's none of your business."

Smolonsky then told Bernstein that he and McLean wanted to examine certain claims files. Bernstein said that only Perry Lisker could provide those files, and Lisker was out of town. Bernstein told Smolonsky that he had called me to inform the Committee that Lisker would not be present for the meeting. This was not true and I had not received such a telephone call.

As the interview concluded, Bernstein accused Smolonsky and McLean of wasting taxpayer's money on their trip to Los Angeles.

Before they left, Smolonsky told Bernstein that the Committee would have a hearing, that Bernstein would probably be asked to testify at the hearing, that Bernstein could possibly be subpoenaed to testify, and that he would not be able to reply, "It's none of your business" to questions at the hearing. Bernstein said that when he received the invitation, he would decide whether he would testify. Finally, Smolonsky specifically told Bernstein that he and McLean had asked these questions because the same questions would arise at the hearing, and in "fairness" to Bernstein, he was being given the opportunity to respond.

The following day, Smolonsky called Bernstein and again asked for access to certain claims files. Bernstein said, "No."

In sum, based upon Bernstein's responses to Smolonsky and McLean, he did not, nor did he want to, cooperate with the Committee in its inquiry.

Subsequently, a letter was sent to Bernstein and Marvin Uritz by the Chairman on February 22, 1982, requesting that they forward the Committee copies of certain files and requesting that they testify at the March 11, 1982 hearing.

Smolonsky subsequently interviewed Perry Lisker of UIB by telephone and asked Lisker specific questions about each case mentioned in the letter. Lisker promised to answer each question in a written response, which he assured Smolonsky would be mailed to the Committee in time for the hearing. This was never done nor were copies of the files requested ever received.

On March 1, 1982, you called me and advised for the first time that you were representing Bernstein in this matter. When I inquired whether in response to the Chairman's request, Mr. Bernstein was going to testify you indicated that he did not want to testify. In response to that, I stated that because there would be a time problem at the hearing due to the Williams' proceeding on the Senate floor, it would be acceptable to the Committee that he not appear, and further that I would send you a transcript of the hearing record that pertained to Bernstein and Market so that Bernstein could respond to any allegations made about the operations of Market or UIB made at the hearing.

We again spoke on March 9, 1982, when upon receipt of your March 2, 1982 letter I telephoned you to correct your misunderstanding that "the Committee does not have sufficient time to hear Mr. Bernstein's testimony." During that conversation I advised you that if Bernstein wanted to testify he could do so, and even though there was a time problem, the Committee would "make time" to hear his testimony. You affirmed that it was not Mr. Bernstein's desire or intention to testify. I agreed that it was still the Committee's intention to keep the record open following the hearing and that Bernstein would be permitted to respond for the record.

In conclusion, although your letter of March 2, 1982, seems to indicate that Market was not treated fairly by the Committee, I believe that the facts outlined above clearly demonstrate otherwise.

Very truly yours,

R. Michael Haynes

R. Michael Haynes
Chief Counsel

cc: Arthur Bernstein

RMH:njm

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March 15, 1982

Mr. Michael Haines
General Counsel
Senate Committee on Small
Business
Washington, D.C. 20510

Dear Mr. Haines:

Please forward to me copies of all press releases and other documents provided to the press and the public respecting the Committee hearing held March 11, 1982 regarding the Small Administration Surety Bond Guarantee Program. Your cooperation and early response will be appreciated. Thank you.

Very truly yours,

Richard D. Turner

RDT/cwp

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United States Senate
COMMITTEE ON SMALL BUSINESS
WASHINGTON, D.C. 20510

March 19, 1982

Richard D. Turner
Eisenhower, Carlson, Newlands,
  Reha, Henriot and Quinn
1200 First Interstate Plaza
Tacoma, Washington 98402

Dear Mr. Turner:

Per your request of March 15, 1982, I have enclosed press information and other documents provided to the public as part of the Committee's March 11, 1982 oversight hearing on the Small Business Administration's Surety Bond Guarantee Program.

The enclosure contains the following material:

1. Statement of Paul Boucher, SBA Inspector General.
2. Statement of William E. Douglas, Department of Treasury.
3. Statement of Mountie M. Bedford, M.B. Underwriters, Inc.
4. Statement of Dr. John Magnotti, American Specialty Surety Council.
5. Statement of Donald R. Templeman, SBA.
6. Committee news release.
7. Fact sheets on case studies discussed at the hearing which involve AFFI, Market and UIB.

Very truly yours,

R. Michael Haynes

R. Michael Haynes
Chief Counsel

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United States Senate
COMMITTEE ON SMALL BUSINESS
WASHINGTON, D.C. 20510

April 28, 1982

Richard D. Turner
Eisenhower, Carlson, Newlands,
  Reha, Henriot and Quinn
1200 First Interstate Plaza
Tacoma, Washington 98402

Dear Mr. Turner:

Pursuant to your request, enclosed is a copy of the transcript of the Committee's March 11, 1982 hearing on the Small Business Administration's Surety Bond Guarantee program. This includes, as well as supplements, the material sent to you on March 19, 1982. This is a final draft copy of the public record and contains all of the testimony and documents introduced at that hearing.

In accord with your request and our telephone conversation of March 9, 1982, the Committee is providing a copy of the hearing transcript to Mr. Bernstein to give him the opportunity to make a response to the testimony concerning the operations of the Market Insurance Corporation or the United Inspection Bureau.

If Mr. Bernstein wishes to respond or include a statement for the record, his response must be received by the Committee no later than May 17, 1982.

If you have any questions you may contact me at (202) 224-8487.

Very truly yours,

R. Michael Haynes

R. Michael Haynes
Chief Counsel

Enclosure

cc: Arthur Bernstein

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May 5, 1982

Mr. Michael Haynes
General Counsel
Senate Committee on
Small Business
Washington, D.C. 20510

**EXPRESS MAIL**

Dear Mr. Haynes:

I received a telephone call on May 5, 1982 from Mr. Bernstein of Market Insurance Corporation advising that he had just received a copy of a letter which you have apparently addressed to me. I understand by the copy of the letter that you have forwarded to me a report of some sort requiring my response by a date in May.

The purpose of this letter is to advise you that I have not received your letter or this report and that I will be out of my office from May 10 through May 23.

I assume this has to do with your sending me a copy of the transcript of the hearings recently held on the Surety Bond Guarantee Program in order that I may prepare, together with Market Insurance Corporation, a written response to allegations made against Market Insurance Corporation at that hearing, which written response will be placed in the record.

Since I have not as yet received the report and since I will be out of the office for approximately 10 days beginning on May 10, I would appreciate an extension of time sufficiently reasonable for me to digest the report, meet with Mr. Bernstein in Los Angeles and prepare a written response to you. Please advise. Thank you.

Very truly yours,

Richard D. Turner

RDT/cwp
cc: Arthur Bernstein

[illegible]

[illegible], STAFF DIRECTOR

[illegible] CHIEF COUNSEL

[illegible]

COMMITTEE ON SMALL BUSINESS

WASHINGTON, D.C. 20510

May 10, 1982

Mr. Richard D. Turner
Eisenhower, Carlson, Newlands,
Reha, Henriot and Quinn
1200 First Interstate Plaza
Tacoma, Washington 98402

RE: Hearing on SBA Surety
Bond Guarantee Program

Dear Mr. Turner:

In response to your letter of May 5, 1982, in which you requested additional time to file a statement on behalf of Mr. Bernstein and the Market Insurance Corporation regarding the above captioned matter, the Committee will extend your time for filing to June 14, 1982.

However, since the Committee has already delayed its printing schedule substantially to give your client a fair opportunity to submit a statement, and since you already have had a great majority of the hearing record since my transmittal of March 19, 1982, please be advised that there can be no further extensions past this date.

Very truly yours,

R Michael

R. Michael Haynes
Chief Counsel

cc: Arthur Bernstein

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May 27, 1982

Mr. R. Michael Haynes
Chief Counsel
United States Senate Committee
On Small Business
Washington, D.C. 20510

Re: Hearing on SBA Surety Bond Guarantee Program

Dear Mr. Haynes:

Thank you for extending the deadline to provide the AFFI, Market and UIB response to the Committee Hearing by June 14, 1982.

In reference to your letter of March 19, 1982, which responded to my request for press information and other documents prepared by the committee preliminary to the hearing of March 11, 1982, I note that for some reason you failed to provide me a copy of the "Overview Memorandum SBA Surety Bond Guarantee Program." I would appreciate any explanation you may have as to why that memorandum was also not included. Thank you.

Very truly yours,

Richard D. Turner

RDT/cwp

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United States Senate
COMMITTEE ON SMALL BUSINESS
WASHINGTON, D.C. 20510

June 2, 1982

Mr. Richard D. Turner
Eisenhower, Carlson, Newlands,
  Reha, Henriot & Quinn
1200 First Interstate Plaza
Tocama, Washington 98402

Dear Mr. Turner:

The Committee has already provided you with copies of all material introduced into the public record and provided to the press at the March 11, 1982 hearing on the Small Business Administration's Surety Bond Guarantee Program, as well as a transcript of the hearing record.

The overview memorandum you refer to in your letter of May 27th, and of which you apparently have some knowledge, was prepared by the Committee staff in preparation for the hearing and for the sole purpose of briefing the Chairman and Members of this Committee and their staff, and to aid the Members and their staff in preparing questions for witnesses at the hearing. This memorandum has not been made part of the public record and therefore was not sent to you for either comment or response.

Very truly yours,

R. Michael Haynes
Chief Counsel

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June 8, 1982

Mr. R. Michael Haynes
Chief Counsel
United States Sentate Committee
on Small Business
Washington, D.C. 20510

Dear Mr. Haynes:

Per our agreement, enclosed herewith please find an original executed reply to the Senate Committee on Small Busines hearing testimony regarding the Surety Bond Guarantee Program held March 11. An executed counterpart of this reply has also been sent directly to Senator Weicker.

Very truly yours,

Richard D. Turner

RDT/cwp
enc.

LAW OFFICES OF

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June 7, 1982

The Honorable Lowell P. Weicker, Jr.
Senate Committee on Small Business
424 Russell Senate Office Building
Washington, D.C. 20510

Dear Senator Weicker:

This letter, including its Exhibits "A" and "B", is submitted on behalf of Market Insurance Corporation and United Inspection Bureau. It is in reply to the testimony provided at the Senate Committee on Small Business hearing held March 11, 1982 regarding the Small Business Administration Surety Bond Guarantee Program and the participation of American Fidelity Fire Insurance Company, Market Insurance Corporation and United Inspection Bureau. By previous agreement, this letter with attached Exhibits will be included in the published record of that hearing.

## COMMENT ON HEARING TESTIMONY

In Senator Weicker's opening statement, he indicated that as a result of a five month investigation by his committee staff, a finding was made that the Small Business Administration (SBA) Surety Bond Guarantee Program (SBG) has lost millions of dollars due to fraud, mismanagement and negligence. It is apparent the committee staff held a close relationship with Mr. Paul Boucher, Inspector General of SBA. The basic thrust of Mr. Boucher's testimony reached a similar conclusion. In addition, Mr. Boucher claimed, directly or by innuendo, and Senator Weicker concurred and supported that American Fidelity Fire Insurance Company (AFFI); Market Insurance Corporation (Market), its former managing general agent for surety; and United Inspection Bureau (UIB), its claim adjusting firm, had committed fraud, were totally mismanaged, and were negligent in their operations. Senator Weicker, based on testimony at this hearing and presumably also based upon his staff investigation, demanded the removal of AFFI from the SBG program and expressed incredulity at the fact that the Treasury Department had not removed AFFI from its treasury list.

Senator Weicker claimed that a surety company named International Fidelity Insurance Co. of Newark, New Jersey, (IFI) had been infiltrated by organized crime and specifically painted AFFI with the same innuendo.

Senator Weicker, the Senate Small Business Committee, and its staff are advised that Market and UIB deny the claims, allegations, innuendo and conclusions made by Senator Weicker and Mr. Boucher.

Some of the statements made and conclusions reached by Mr. Boucher and Senator Weicker indicate a lack of knowledge of the surety industry and little regard for true facts. A small sampling of the hearing record, to prove this point, is set forth below.

1. Mr. Boucher: ". . .'specialty companies' specialize in and to a significant extent subsist on the business they write in the Surety Bond Guarantee Program."

Reply: Participation in the SBG program probably does not account for more than 15% of the total annual premium volume of any "specialty company."

2. Mr. Boucher: (a) "Upon default, claims attorneys or claims adjustors for the surety company select a contractor to complete the unfinished project."

(b) Exhibit VII, internal SBA memo dated December 8, 1981: In at least 98% of defaults, AFFI opts to complete the job.

Reply: Surety companies in general, and AFFI specifically, will rarely select a contractor to complete a defaulted job. Regarding AFFI, this may be done in 10% to 20% of default cases.

3. Mr. Boucher: The Inspector General referred to a 1977 review by the office of Inspector General of surety claims filed with SBA which was made for the purpose of finding evidence of fraud, mismanage-

ment or other indications of program weakness. In that review, the Inspector General made certain findings and conclusions of fraud, violations of U.S. Treasury underwriting limitations, inadequate underwriting and so forth. Mr. Boucher again reported on the conclusions in that report at this hearing, five years later.

Reply: The response AFFI made to the above-referenced 1977 Inspector General's review, which incorporated a G.A.O. study, is enclosed herewith as Exhibit "A" and incorporated herein by reference.

4. Mr. Boucher: (a) There exists "an absence of any incentives on the part of sureties to minimize losses."

(b) "At the present time, some sureties have virtually no risk of loss in this program. In many cases, even their 10% of the loss on a default is passed back to its agents."

Reply: In 1978, at the request of SBA, the Surety Bond Legislation was amended to include an agent within the definition of a surety. Therefore, all risk of loss is, by definition, with the surety.

Additionally, Mr. Boucher is probably referring to retrospective contracts that often exist between and among surety, managing general agents and general agents. If Mr. Boucher would review these contracts and understand them, he would realize that risk of loss is with all parties to those contracts.

Depending upon the nature of the guarantee, a surety has a 10% to 20% exposure on each bond. Ordinarily, that percentage exposure would be to the limit of the penal sum of the bond but it can extend to amounts in excess thereof. The surety bears this loss. Mr. Boucher should understand that if the surety did not succeed in efforts to minimize this loss through underwriting and claims handling, the accumulated dollar value of this 10% to 20% exposure on bond losses incurred to date would greatly exceed premium received by the surety. Indeed, without these efforts by sureties, they would all be in a loss position on their SRA surety bond business.

5. Mr. Boucher: Quoted a New York State insurance commissioner's report that AFFI had consistently underestimated reserves.

Reply: Mr. Boucher, for some reason, failed to state that the New York State Insurance Commissioner also found that the inadequacy of the case reserves set by AFFI were more than compensated by the AFFI reserve set for development and incurred but not reported losses (IBNR). In particular, the New York State Commissioner's report states the following:

> As noted, the reserving practices during the period under review leaves much to be desired. It should be noted nevertheless, the company has included a substantial provision for an IBNR and deficiency reserve to cover the shortages. A further increase in this reserve in 1979 has been carried in the examination loading for IBNR.

New York Department of Insurance, Triannual Report-AFFI. (Emphasis added).

We cannot account for the failure of Mr. Boucher to recognize the existence of the substantial provision for development and IBNR made by AFFI.

6. Mr. Boucher: (a) There is an absence of management and control by AFFI and its affiliates (Market and UIB).

(b) Relating to mismanagement, lack of control and fraud, and in response to a question from Senator Weicker, Mr. Boucher stated that it was his information that the loss default rate of AFFI as a participant in the SBG program was about 62% "according to insurance industry standards."

(c) Mr. Boucher was asked by Senator Weicker how much the government is losing "unnecessarily" through the SBG. In response, Mr. Boucher testified that, based upon the procedures he had seen and, looking only at contracts written AFFI and IFI, it is quite possible--quite likely--that we are talking about "several millions of dollars in further losses just with these two companies alone."

Reply: We assume that if AFFI, Market and UIB are totally mismanaged, and we further assume that if there is a complete lack of controls operating within the AFFI structure, then AFFI's performance record in the SBA surety bond program, as compared to other sureties, would reflect this rather insidious allegation of lack of management and control.

Mr. Boucher does not explain how he arrived at a figure of 62% as a loss ratio for AFFI. The only valid standard that can be used is a cumulative loss ratio by premium or contract indemnity, but the same cumulative measure must be used for all the companies in the SBG program. Additionally, Mr. Boucher should use only statistics relative to the SBG program and no other bonding activity of any other companies.

Using statistics published by SBA, the cumulative loss ratios of the principal companies participating in the SBA Surety Bond Program are as follows:

| Company | Loss Ratio[1] |
|---|---|
| American Druggists | 1.41% |
| AFFI | 2.65 |
| Balboa | 2.05 |
| Builder's Risk | 3.00 |
| Dependable | 2.88 |
| Heritage | 2.90 |
| ICNA | 4.52 |
| International Fidelity | 4.03 |
| Integon | 2.60 |
| Morrison | 2.47 |
| National Bonding | 2.44 |
| Sentry | 3.23 |

Based upon the above, the average loss ratio, is 2.93%.

We believe AFFI, Market and UIB are well managed. If that is true, then the other surety companies named in the above chart are also, on a comparative basis, well managed.

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[1] These loss ratios are determined from SBA statistics, adjusted as follows: (1) The chart assumes that, on average, very few claims surface within 1-3/4 years after bonds are written. (2) On this basis, we applied the total cumulative losses reported by SBA "loss statistics as of 3/31/82" and divided the total cumulative losses by cumulative indemnity as reported by SBA, report dated 6/30/80.

This method may overstate or understate the loss ratio by a margin of 10% of the total loss ratio. However, that same margin would hold for all of the companies named in the chart. Therefore, the chart remains a valid comparative measurement and is probably as close as possible to an exact measurement of actual loss ratios.

If AFFI, Market and UIB are not well managed, then the other companies named on the above chart, on a comparative basis, are not well managed.

If Senator Weicker demands that AFFI be removed from the SBG program because of its mismanagement, then based on the above comparisons, Senator Weicker must also demand that all of the above-named companies be removed as well. If Senator Weicker demands that AFFI be removed from the Treasury List by the Department of Treasury, based on its mismanagement, then Senator Weicker, based on the above comparisons, must also demand that all of the above-named companies also be removed from the Treasury List by the Department of Treasury.

The fact that we believe AFFI, Market and UIB, as well as the other companies named in the above chart are well managed, does not mean that Senator Weicker or Mr. Boucher could not, in hindsight, review a particular file, among thousands of underwriting files or thousands of claim files, and find some aspect of a file not fully documented. However, in the face of these loss ratio comparisons, it is blatant error to claim AFFI is totally mismanaged based on a review of less than 50 claim files.

7. Mr. Boucher: In discussing with UIB the manner in which it accounted for legal fees, Mr. Boucher stated that "there was some double billing going on."

Reply: UIB categorically denies Mr. Boucher's statement.

Attorneys fees incurred in the handling of bond claims are reimburseable to the surety on a percentage basis, pursuant to the SBA Surety Bond Guarantee Agreement. Independent counsel retained by UIB in various areas of the United States bill AFFI through UIB at their hourly billing rate. These attorney's fees are paid by AFFI and AFFI then seeks 90% or 80% reimbursement from SBA pursuant to the terms of its guarantee. AFFI also pays UIB a fee based on its staff attorney's work product on SBA bond claims based on rates similar to or less than rates charged by independent counsel in the same market area as the location of UIB. Their work product is not duplicative, nor are its billings duplicative.

The salary that UIB might pay to one of its staff attorneys is of no more significance in this regard than the salary a lawfirm might pay to an associate attorney performing work product on a SBA surety bond claim. The lawfirm billing rate to AFFI would be in excess of the salary paid to the associate attorney in order to account for costs of overhead and profit to the law firm. That same situation exists with the UIB attorney fee billings to AFFI. That same situation should exist with respect to any service or professional business.

8. Senator Weicker
and Mr. Boucher: Testimony was given by Mr. Boucher that in September of

1980, this same committee heard testimony that Mr. Irwin Weiner was an organized crime associate and a general agent for IFI. Apparently, Mr. Weiner had written a number of bonds guaranteed by SBA. In this hearing, Senator Weicker and Mr. Boucher rediscussed Mr. Weiner's organized crime connection. Senator Weicker then asked Mr. Boucher what could be done to keep organized crime out of the SBA surety bond program. Senator Weicker stated the following:

"Well, what bothers me is the organized crime connection, what was well established at the last hearing, and yet SBA and the Treasury Department are still permitting people, from the very same companies that have that stigma attached, to carry on the same as before. I mean, what is necessary to have somebody say, "no, we are not going to license you?" (Emphasis added).

Senator Weicker made it very clear in the hearing record that he was speaking of IFI and AFFI.

Reply: Market and UIB know nothing of IFI and whether representatives of IFI are also representatives of organized crime. However, there has never been any testimony in any previous hearings before the Senate Small Business Committee, nor during this particular committee hearing, to suggest that anyone connected with AFFI, Market or UIB was also somehow connected to organized crime. Senator Weicker's statement is denied categorically.

In fact, it appears on the record of this hearing that it is sufficient for Senator Weicker to unilaterally attach a "stigma" of organized crime to AFFI and that "stigma", without any facts to support it, appears to be enough for Senator Weicker to demand removal of AFFI from the Treasury List and from the SBA Surety Bond Guarantee Program. Certainly, any reasonable man would agree that AFFI deserves better treatment than that.

9. Senator Weicker: The hearing record sets forth that Senator Weicker used an Argus loss ratio chart (the chart was not placed in the record as an Exhibit). Senator Weicker indicated the Argus chart showed the Balboa loss ratio to be 4.5% and compared it to the AFFI loss ratio which Senator Weicker

stated to be 61.7%. The obvious purpose for this presentation was to discredit AFFI.

Reply: The Argus loss ratio chart has absolutely no relevancy to SBA surety bond business.

First, the Argus loss ratio chart reflects results on all surety business of a surety company, not just SBA Bond guaranteed business. Both Balboa and AFFI are engaged in writing surety bonds for construction; for license, permit and miscellaneous bonds; and for construction under the SBA Surety Bond Guarantee Program. In addition, AFFI engages in re-insurance of other companies on surety business.

Second, on the Argus chart, all surety business is reported "gross before reinsurance". Therefore, the use of the Argus chart for actual net loss ratio in the manner used by Senator Weicker is not possible, even for a surety company that does not engage in SBA Surety Bond Guarantee business.

Third, as respects the reporting of surety business, the Argus chart reflects loss ratios after indemnity recovery is subtracted from the current year's loss payouts, with the net amount being shown as the current year's loss. Obviously, indemnity recovery in surety takes a considerable period of time and is often recovered from three to six years after the original loss has occurred. Consequently, if Senator Weicker would peruse several Argus charts, he will often find a surety company showing a negative loss ratio in surety for the reporting period, solely due to the fact that recoveries from previous year's losses were greater than the current year's loss payouts. For example, if a company does $1,000,000 in premium for each of the prior five years, but only $100,000 in the current year, the Argus Chart will show $100,000 of earned premium. However, the losses which come in the current year are losses from the prior five years of $5,000,000 cumulative premium. Therefore, if those losses are $1,000,000 which, in reality, would be a 20% to 30% loss ratio, the Argus Chart would show a 1,000% loss ratio. Conversely, if a company had been writing $100,000 a year for five years and increased its business to $1,000,000 in the current year, the Argus Chart would show $1,000,000 of earned premium. However, as losses in the current year are an accumulation of losses of the past years, and if this company also is enjoying a 20% to 30% loss ratio, the reported losses for the current year as per the Argus Chart would be $100,000. The Argus Chart would then show a 10% loss ratio, which obviously is a distortion. Added to this distortion is the previously mentioned factor of indemnity recovery, which is actually a reflection of recovery on losses of 3 to 6 years prior.

Finally, the purported conversion by Senator Weicker of AFFI's loss ratio on SBA business only from the methodology used by SBA to the methodology used by the standard surety companies on standard surety business, without also making that same conversion on Balboa's SBA's business only (or any other surety company Senator Weicker wishes to compare with AFFI) certainly appears to have been done deliberately for the purpose of unfairly discrediting AFFI.

10. Senator Weicker: The Senator made a statement that he was informed of "disturbing information" about AFFI and Market regarding a matter before the California State Insurance Commissioner. Because of this matter, Senator Weicker suggested SBA take administrative action against Market.

Reply: Attached hereto as Exhibit "B", and incorporated herein by reference, is a letter dated March 29, 1982 forwarded to SBA by Mr. Bernstein explaining the matter before the California Insurance Department.

First, AFFI was not a party to the action before the Commission.

Second, the matter involved alleged technical violations of the California State Insurance Regulations, violations which Market denied, but the alleged violations by Market were no different than the same alleged violations committed by two of the largest insurance groups in the United States, Mission Insurance Group and Continental Insurance Company. Subsidiaries of these companies, as well as Market, were given the same small fines by the California Insurance Commissioner's office for the purpose of establishing, as an example to the insurance industry in California, that the industry's custom of investing premiums in municipal bonds and repurchase securities trust accounts was not acceptable. As you will see from Exhibit "B", the California State Legislature subsequently amended its laws to allow those exact same investments on repurchase securities previously objected to by the Commission. Market reluctantly agreed to pay the fine (as did the other insurance companies) and that is the only fine ever imposed upon Market or its principals in over sixty years of combined service to the insurance industry.

Let it also be noted that there is probably not a "standard" or a "specialty" insurance company that has been in business for any great length of time that has not, at one time or another, in some state jurisdiction in which it operated, received notice of some technical violation of that state's insurance code or regulation and paid a fine or monetary settlement for said violation.

11. Senator Weicker

and Mr. Boucher: The Senator asked Mr. Boucher to explain his findings with regard to an audit of approximately five AFFI claim files. As a result of this audit, Mr. Boucher made claim that millions of dollars were being lost because of fraud and mismanagement by IFI and AFFI alone. These conclusions were supported by Senator Weicker.

Reply: Mismanagement is a non-issue. The rebuttal to this claim is set forth in paragraph 6 above.

As regards fraud, Market and UIB categorically deny involvement in fraud. In one of the cases testified to by Mr. Boucher, a fraud appears to have occurred. It was not committed by AFFI, Market or UIB or any producing agent of Market. The fraud was committed by a contractor. The fraud was not discovered by Mr. Boucher; rather the fraud was discovered by UIB in its investigation of the bond claim. Upon its discovery, UIB turned that information over to SBA with a recommendation that it be referred to the Justice Department. This information was in the UIB claim file and readily provided to Mr. Boucher at the time of his purported audit.

If Senator Weicker can develop underwriting techniques that will totally eliminate the possibility of a fraud being perpetrated by a contractor on a surety, Market would be pleased to install those underwriting techniques into its business.

Any business function can be improved. Market and UIB constantly seek to improve the functions of underwriting and claims handling. We assume all other companies in the surety industry seek the same improvement. Mistakes are made, but never knowingly or intentionally. They are discovered in hindsight. In the history of the SBA Surety Bond Guarantee Program, AFFI and Market have underwritten thousands of bond applications and UIB has supervised the handling of thousands of claims. In that context, it is improper, let alone unfair, for Mr. Boucher or Senator Weicker to make wholesale claims of fraud and total mismanagement upon AFFI, Market or UIB on the basis set by Mr. Boucher.

AFFI's loss ratio is below the average of the loss ratios of the companies listed above. It seems to us that the comparative ability and legal right of a surety to participate in this SBA program should, in part, be based upon its comparative performance measured as such, rather than a subjective review of claim files, regardless of the statistical invalidity of the low number of claim files reviewed.

## CONCLUSION

Senator Weicker has done a great dis-service to AFFI, Market and UIB. Prior to this hearing, Senator Weicker issued a press release claiming the government has lost millions of dollars in this program through fraud, mismangement and involvement of organized crime figures. During the Committee hearing, Senator Weicker proceeded to involve AFFI, Market and UIB in these allegations. Their reputations in the business community have been unjustly and severely damaged. The Senate Committee on Small Business published an "Overview Memorandum SBA Surety Bond Guarantee Program" containing the claims and allegations made by Senator Weicker at the hearing itself. This information was disseminated nationally by the press, causing additional and unjustified damage to AFFI, Market and UIB.

We appreciate the opportunity Senator Weicker and his Committee has provided for this response of Market and UIB to be submitted as a part of the hearing record. Although it will not repair the damage done, perhaps it will assist in promoting a better working relationship between the Senate Committee on Small Business and SBA and the surety industry.

Very truly yours,

Richard D. Turner

RDT/cwp
Enclosure

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TELEPHONE
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October 5, 1979

Henry Eschwege, Director
Community and Economic Development Division
US General Accounting Office
Washington D. C. 20548

Re: Draft Report: "The Surety Bond Guarantee Program:
Significant changes are needed to
improve its effectiveness"

Dear Mr. Eschwege:

Your letter of 9/18/79 addressed to Mr. Luther Williams, president of American Fidelity Fire Insurance Company, has been referred to the undersigned for the purpose of providing comment on behalf of AFFI. We appreciate the opportunity you have provided to make those comments.

We hope that the comments set forth herein below will be helpful to you. However, it is apparent that we have not received the entire draft report. In fact, your cover letter states that you have forwarded to us only segments of the draft report. We believe it would have been more helpful to the comment process if we had been provided a copy of the entire draft report and we express the hope that our comments will not be out of proper context by reason of the fact that there are obvious gaps in the draft forwarded to us.

Set forth immediately below are specific comments which we have made regarding specific statements or conclusions set forth in the body of the draft report. In so doing, we have attempted to follow your outline as closely as possible, and set forth below our specific comments are some general observation which we thought might be helpful.

PERSPECTIVE

This section states, in part, that in adopting the Surety Bond Guarantee legislation, Congress intended to assist small contractors to develop sufficiently to secure bonds without the guarantee. This is not correct. The Surety Bond Guarantee legislation was passed by Congress because it found that a certain segment of the contracting industry could not get bonds. The legislation was passed to enable those contractors to better obtain bonds.

**EXHIBIT A**

## SURETY BONDING

Under this section, on page two of the draft, is set forth the definition of a bid bond, performance bond, and payment bond. We believe those definitions are not correct. Neither of the three bonds are a "joint" guarantee by the contractor and the surety. A bond is issued by a Surety, not jointly by a Surety and a contractor. In the strict sense of the term, a bond is also not a guarantee. Were it otherwise, a Surety could have no defenses to its bond obligation. As you may know, a Surety can have defenses to its bond obligations and it is therefore not a strict obligatory guarantee.

## PROGRAM COST

On Page four of your draft is a paragraph concerning program cost. These costs should be placed in a proper context, which we believe is the federal budget. In 1977, the economic research branch of the SBA issued a report which was mandated by Congress entitled, "A Study of the Surety Bond Guarantee Program, 1977". It found that the federal government had saved money by reason of the Surety Bond Guarantee Program, taking into consideration its direct cost, by reason of the fact that the savings on the bid spread between the contract awarded to the contractor obtaining the Surety Bond Guarantee and the second low bid was so substantial that it resulted in a dollar savings in excess of the direct cost of the Surety Bond Guarantee program. If I recall the figures correctly, the combined savings of federal and local governments was $145 million and the Federal Savings approximated $3 million. At that time, obviously, the direct program costs were less than the costs cited in your draft report of $98.4 million. Still, the $98.4 million is less than the savings of $145 million as of 1977. Nothing has occurred in the program since 1977 to destroy the logic of that report. If you would interpolate those figures to date, you would find that the conclusion would not change; that is, that this program results in a net savings to the federal budget.

## SCOPE OF REVIEW

In analyzing your scope of review, certain overall statistics should be known. They are the following:

As of April 30, 1979

| | | |
|---|---|---|
| 1. | Guarantees requested | 172,660 |
| 2. | Guarantees approved | 165,043 |
| 3. | Contracts obtained | 91,567 |
| 4. | Contract indemnity | $6.3 Billion |
| 5. | Default notifications | 5,593 |

The above sets forth total relevant program activity as of April 30, 1979. In that context, your draft report states you reviewed the following:

1. 273 randomly selected contractor files broken down as follows:
    a. 150 Contractor files reviewed for underwriting
    b. 123 Contractor files reviewed to determine graduation statistics.
2. 34 files of defaulted contractors were reviewed to evaluate claim and underwriting functions

We recognize that your review of these files was random rather than statistically determined; however, in view of the fact that you have made rather broad and sweeping conclusions about program changes from a review of such a very limited number of files, we believe you should set forth your random sampling ratios. They are as follows:

1. Contractor files - 273 divided by 172,660 = .00158
2. Underwriting files - 150 divided by 172,660 = .0087
3. Default files - 34 divided by 5,593 = .0060

On the basis of this limited statistical analysis, we believe that the conclusions which are either implicit or explicitly set forth in the draft which you forwarded to us cannot be validly made. This conclusion is reached without giving consideration to the subjective analysis that was obviously made by the staff and your consultant. Comments on that subject are below.

## UNDERWRITING INFORMATION IS OFTEN OUTDATED, INACCURATE, INCONSISTENT, OR INCOMPLETE

Having set forth in your scope of review section the number of files reviewed and the purpose for which that number was reviewed, we became confused by reading this section. It states that you reviewed 639 applications. This number does not seem consistent with the numbers which you set forth in your scope of review.

Again, in view of your broad criticisms of the program we believe it should be pointed out that even this figure amounts to only .0037 or 1/3 of one percent of all applications submitted.

On this review, your criticism is that one or more elements of data were outdated, inaccurate, incomplete, or inconsistent.

One primary comment we make is that an application should be reviewed as a whole. Assuming that, it is not appropriate to look at one element of data out of context with all other elements of data represented on an application.

Also, it would be helpful if these terms were defined in your report and their relevancy to proper underwriting should also be set forth. For example, inaccuracies may be significant or not significant yet in your report they remain inaccuracies. An application may be incomplete in a manner that is significant or not significant yet in your report it is incomplete.

Your report concludes that a significantly high percentage of applications contain "underwriting deficiencies." What is, in the eyes of your staff or your consultant, an "underwriting deficiency"? Is that deficiency significant or not significant? In either case, in your report it is a deficiency.

These questions become all the more relevant and meaningful when program results are compared against your findings. For example, your report finds that 100% of all applications reviewed at the Chicago regional office and the Nashville district office contained underwriting deficiencies. Is the loss ratio in the Chicago regional office and the Nashville district office also one hundred per cent? Is the loss ratio in Atlanta 90%? Obviously not. Therefore, we believe your analysis and your conclusions have little value in assisting either SBA or Surety companies in improving their work. Your report as much as admits this in that it states that some of these underwriting deficiencies would not have significantly impacted SBA's decision on the application.

## WORKING CAPITAL AND NET QUICK ASSETS

Your definition of net quick assets is one that may be used, but not always. It is a definition that is often used by standard Surety company underwriters in underwriting major contractors bidding on major construction projects, often involving millions of dollars. It is not always useful in underwriting the class of contractor in the SBA Guarantee program unless, of course, the goal is not to write bonds for contractors. For example, a small contractor might have his entire inventory earmarked for a particular job for which he is requesting a bond. In that case, he should be given credit for one hundred percent of that inventory. Another example; even though a contractor may have no net quick assets or even a negative net quick in assets, if he can show that the first week or two of a small project's cost are covered, either by a line of credit or by a loan from some third party, and that remaining costs can be covered by future progress payments, the fact that he has no net quick assets or negative net quick assets might not cause that contractor to be rejected.

Your report states that nearly one third of applications reviewed did not accurately report working capital and more than one half misstated net quick assets. Again, we must ask, how inaccurate is inaccurate? Are these inaccuracies significant or not. If they are not, why do you reach the conclusions that you do? If they are significant, then it would seem to us that the ratio of defaults should be roughly equal to the number of defects you found in the applications involving working capital or net quick assets. We believe program statistics would not bear out this latter conclusion.

Under this section, it is further stated that your consultant's review of selected default cases showed that many applications overstated the contractor's financial positions. How many "did so"? Only 34 default files were reviewed. It would seem that by reason of the fact that so few files were reviewed, and by reason of the fact that the analysis is so highly subjective, that the value of your conclusions can be limited only to the specific file that your consultant reviewed.

Greater value from your analysis could be obtained if you would be able to determine the reason for the default and then analyze whether the default was in any way attributable to the "deficiency" noted in the application. We believe that both Sureties and SBA could learn from such an analysis. As I am sure your consultant must know, a contractor can default for reasons totally unrelated to information set forth or not set forth on his application.

WORK IN PROCESS

We would pose the same questions with respect to this analysis as above. Further, it should be pointed out that if a contractor is new, he may not have any work in process. If he has no work in process, there may not be a report regarding work in process on file.

If we assume that in your review of 150 files, you found 31% not to contain a report on work in process, then we would ask whether or not the SBA was aware of the lack of such a report. Assuming that, and also assuming that the agent was aware of the lack of such a report, we must then ask how relevant the existence of such a report is. Was the lack of such a report directly attributable to a default? Was there other information in the file from which sufficient information regarding work in process could be obtained?

GENERAL INDEMNITY AGREEMENTS

We believe that all contractors should provide indemnity to the Surety, not only its business entity, but also the principals involved. In this section, and under the "surety bonding" section, the report makes reference to the fact that the Surety can sue the contractor to recover its loss. While this is correct so far as it goes, the report should make clear that because of the high-risk nature of the class of business being bonded under the Surety Bond Guarantee Program, the opportunity to make any recovery against the contracting business entity or the principal owners thereof is relatively rare. It makes little sense for a Surety to bring suit against a defaulted and bankrupt contractor to recover a loss. The end result of such an effort is no more than to increase the amount of the loss.

At the top of page ten of your draft report is a paragraph stating that SBA found significant discrepancies in data submitted by surety agents. Six examples are cited. We believe SBA should be complimented for its work. We believe that both general agents and SBA do their best to make sure that applications are complete and accurate. SBA is and for some time has been significantly understaffed. If the manpower and productivity of the Surety Bond Guarantee Program were compared to the manpower and productivity of its bank guarantee program or any other program within SBA, we firmly believe you would find that SBA does far more in this program with far fewer people than in any other program.

Important elements of the program would work in more rapid fashion if SBA were given an adequate staff. That is not to be understated in its significance. Bond applications must very often be analyzed in a very short time frame. In addition, Sureties are losing significant dollars by reason of the fact that SBA cannot process claim reimbursements in a reasonable time frame. Adequate staffing would help in this regard. Additionally, we believe that the addition of staffing could help eliminate the processing of bond applications that are not fully complete or perfect in their presentation; however, in so stating, we will always admit that the GAO will always be able to find out of 273 randomly selected files, a certain number of files that will not be totally and perfectly complete and accurate.

## CONSULTANTS OTHER OBSERVATIONS

Under the above titled section, the consultant reviewed 18 files and found them to be inadequate in their underwriting. As previously stated, we do not believe that sampling to be sufficient to justify the broad conclusions reached in the report.

We believe it would be helpful if you would define terms under this section. For example, what is "unacceptable underwriting"? What is "marginal underwriting"? What is "poor underwriting"? Underwriting is subjective. Also, the underwriting analysis and decision-making process in underwriting the class of business participating in the Surety Bond Guarantee Program is far different from that which obtains in the standard surety market. The underwriting standards that the consultant used in making this analysis should be set forth so that independent decisions may be made as to the validity of your consultant's conclusions.

Underwriters have often stated that if a certain set of facts were given five different underwriters, five different underwriting conclusions could be reached. That might be even more so when considering the class of business being written in the Surety Bond Guarantee Program. Assuming this to be valid, it would be even more appropriate for the case histories of the files the consultant reviewed to be set forth as well as his underwriting standards. Without that information, very little value can be obtained from this section of the report.

## UNDERWRITING GUIDELINES ARE INADEQUATE

It is incorrect to state that participating Sureties have not established useful underwriting guidelines to assist surety agents in analyzing or underwriting bond requests. Speaking for American Fidelity Fire Insurance Company only, it does have established guidelines. However, those guidelines are by necessity general in scope by reason of the varied risks that are underwritten in this program. This is not necessarily the case in the standard surety market because the contractor being bonded is not a risk. If it was, the standard market would not bond that contractor.

## SBA AND THE SURETY COMPANIES ARE NOT MINIMIZING LOSSES

The first paragraph under this section states that neither SBA nor the Surety companies adequately monitor contractor progress. It is not the function of the SBA to monitor contract progress under any circumstances From the inception of the program, it has been the position of SBA that it should stand in a similar position to a private sector reinsurance company: that is, that all underwriting, processing and claim responsibilities should rest with the Surety company and that SBA should follow the fortunes of that Surety. It sould be improvident for SBA to parallel or duplicate any work responsibility of the Surety.

Your report makes a conclusion that contractor progress is not adequately monitored. We believe it would be helpful if the standards which you used in judging this aspect of the surety business would be published in your report. Without our ability to review the standards by which we are being judged, it is very difficult to either agree or disagree with any conclusion stated therein.

Prior to the last amendments to the Surety Bond Guarantee legislation, there was reluctance on the part of Sureties to expend funds in the avoidance of a possible default and for the purpose of minimizing losses because SBA, contrary to its guarantee agreement, on various occasions attempted to take the position that it was not required to reimburse Sureties up to 90% of the expenditure of those funds. Under the current premium structure and sharing of premiums in the surety bond guarantee program, and by reason of the very small size of contracts generally guaranteed in the program, the profit margin is very thin. Further, the progressing state of the law with respect to the rights of the contractor, the rights of the owner of the project, and the correspondingly limited rights of the Surety, all work against the ability of a Surety to monitor job progress.

Also in this section is a quote from a July 1977 memorandum from SBA general counsel. In this memorandum, certain Sureties unnamed are referred to as "mail drop" Sureties. We would like the opportunity to review this memorandum in its entirety for proper comment. Absent an ability to do so, we can only say that the quote contains nothing legal in nature, contains nothing that appears to be in the nature of a legal opinion, but does seem to state one person's particular bias. That general counsel should be informed that no Surety may bond gov't. contracts, for example, without first being approved by the U.S. Department of Treasury. We do not believe the Treasury Department maintains a category called "mail drop" Sureties.

SPECIALTY SURETY COMPANIES ARE COSTING SBA MORE THAN STANDARD COMPANIES

This is a conclusion with which we disagree. Your conclusion seems to be, in part, based upon a finding that Specialty Surety companies have a more extensive use of outside attorneys than do the Standard Surety companies.

Preliminarily, we believe you should have an understanding of a basic difference between Standard Sureties and so-called Specialty Surety companies. Standard Surety companies are, generally, a part of large multi-line insurance companies. As such, surety is a very small aspect of their business and is offered to clients as a method of obtaining or maintaining other far more profitable lines of insurance with those clients. Furthermore, in order to service other lines of insurance, these large multi-line insurance companies have often installed throughout the country multi-line claims branches. It is within these claim branches that multi-line insurance claims are handled by these companies, including surety claims. To the extent they do not have the capacity to handle such claims, they are referred to outside counsel.

The antithesis of a multi-line insurance Surety company is a Specialty Surety company. It simply is small. It cannot afford this network of branch offices to service only surety claims.

On Page 14 of your report, again the general counsel's memorandum of July 1977 is quoted this time to state that a "Surety company 'should have' adequate in-house legal resources...." How can this gentleman make such a statement? What authority does he bring to the subject? This is apparently one man's opinion and we believe that your utilization of it in support of your conclusions in this section of your report is not legitimately justifiable. That quote simply has no credibility.

In this section it is stated that Specialty Surety charges for outside attorneys and claims adjustors significantly exceed Standard Sureties. The above is, in part, an explanation of that fact. By reason of the fact that Specialty Sureties are small, its utilization of outside counsel and consultants is by necessity greater. However, your review of one, two, or any small number of cases to determine the percentage of attorneys fees or costs, relative to the total loss, is not a justifiable basis for making a wholesale conclusion on the subject. For example, in one particular case, after default, the project owner made claim against the Surety for an amount approximating $45,000 for the repair of an irrigation line. The Surety attorney set up appropriate Surety defenses to the claim of the project owner. The case was ultimately settled some two years later for the amount of $4,000 payable from the Surety, but the attorneys fees and consultants fees and costs incurred in reaching that settlement exceeded $10,000. Thus, in this case, the attorneys fees exceeded the amount of the ultimate loss, but without the expenditure of those attorney's fees, the total loss would have been far in excess of the ultimate loss.

If it is the objective of the General Accounting Office that attorneys fees should be less than the loss payouts, it would be a very simple matter of adjustment for the Sureties to simply pay all losses upon claim being made and hire no lawyers to defend where appropriate. Of course, losses would then be far in excess of premium which would require an upward adjustment in premium.

We would request, if the GAO insists upon comparing Standard Surety company loss ratios with Specialty Surety companies, that this analysis be done on a correct basis. The following analysis does so:

July 31, 1979

| Standard Company | Losses | Contract Indemnity |
|---|---|---|
| Aetna | 1,399,051 | 38,647,767 |
| Firemen | 159,458 | 7,305,510 |
| Hartford | 389,727 | 29,688,961 |
| Maryland Casualty | 48,409 | 2,150,000 |
| Travelers | 958,202 | 83,706,330 |
| USFG | 2,660,723 | 151,210,120 |
| | 5,615,570 | 312,708,688 = 1.79% |

The combined loss ratio of the above companies is 1.79%. As of that same time period, the loss ratio of AFFI was 1.7 on a volume of contract indemnity that is more than six times the combined volume of the companies listed. The point to be made in this section is that the productivity of a particular company and its rate of relative success in this program can be monitored fairly only by a review of these aggregate bottom line figures. In so doing, regardless of how certain cost elements might break out as compared to one another, the total loss ratio is the ultimate test. In making this comparison, it can be seen that the Standard Sureties offer little in any way of total participation in the program and their combined loss ratio as above is worse than that of the largest single Specialty Surety participant in the program.

Therefore, we do not believe that Specialty Sureties bring higher losses to the program than do Standard Sureties. However, on the other hand, we do believe that Specialty Sureties bring substantially more income to the program and substantially more contractors to the program than do the Standard Sureties.

The general counsel's memorandum of July '77 is again quoted this time to state that SBA has permitted the creation of a whole new industry. It is not correct to state that this occurred. However, it would be correct to state that this industry, which is by definition the bonding of contractors otherwise not bondable in the standard market, has substantially increased by volume by reason of the creation of the Surety Bond Guarantee program. Furthermore, we do not believe there has ever been an "expansion of the definition of loss". The definition of loss has been clear from the inception of the program and is stated with some particularity in the original guarantee agreement executed between SBA and Sureties.

## THE PROGRAM IS NOT GRADUATING SIGNIFICANT NUMBERS OF CONTRACTORS

This section contains a statement that few contracts are graduating. It also contains a statement that certain active contractors qualify for private bonding.

We believe it would be very helpful for your consultant to set forth the standards by which he determined that certain contractors are qualified for the standard market. It would be further beneficial if the consultant would determine why those contractors are not bonded in the standard market.

It seems to us that any contractor being bonded through the Surety Bond Guarantee Program who is qualified to be bonded in the standard market would seek and want to be bonded in the standard market. If that contractor would do so, he would save in premium approximately one-third of its cost. This would render that contractor far more competitive than he is by being bonded in the Surety Bond Guarantee Program.

During the years 1973-1978, Standard Sureties did not operate at a profit. During those years, Standard Sureties began a process of eliminating contractors that they had previously bonded for fear of resulting defaults. During those times, it would indeed be strange for those same Sureties to be accepting contractors graduating through the SBA Surety Bond Guarantee program.

Graduation is a concept that came into being approximately two or three years ago. In fact, the Senate Select Committee on Small Business recently held a hearing dedicated to this subject. As previously stated, it is not the intent of this legislation to graduate contractors into a Standard Surety market, however, that is a benefit that contractors should hope to attain. There is a substantial substandard market in which Specialty

Surety companies are operating. A portion of that market is devoted to the Surety Bond Guarantee program. It contains contractors rejected by the Standard Sureties, new contractors, tomorrow's new contractors, and existing contractors that are existing or growing through this program. Factors such as competition and economics would unilaterally drive these contractors to the standard market if it would accept those contractors.

## GENERAL OBSERVATIONS

As can be gathered from our previous comments, we believe that, in general, the conclusions of this report are not substantiated by its base audit. There are two reasons for our conclusion. 1) The random sampling of files was not adequate as a percentage of the total files; 2) The criticism of various underwriting and claims elements are criticisms of subjective elements. In so doing, the standards against which these subjective judgments were made are not set forth in the report.

Conclusions regarding application deficiencies or inaccuracies are set forth as if they are all substantive. If there are any disclaimers to that effect, they are well hidden. The standards by which these alleged deficiencies or inaccuracies are measured and determined are not set forth.

We believe that SBA personnel are performing their functions to the best of their ability. However, we believe that SBA is significantly understaff in its claim handling responsibilities and claim reimbursement responsibilities. It is difficult to find any compliment for SBA personnel in your report and, under these circumstances, we believe there is room for compliment. But we also believe a great service would have been provided if your auditors would have recognized the inadequacy of the SBA staffing and recommended methods of solving those problem areas.

We again thank you for the opportunity to have reviewed segments of your draft report. If you have any questions, please feel free to call.

Very truly yours,

Richard D. Turner

RDT/jsn

CC: Luther Williams, American Fidelity Fire Insurance Company

*Market Insurance Corporation*
*15910 Ventura Boulevard, Suite 1400*
*Encino, California 91436*
*(213) 788-6900/from L.A. 872-3055*
*Telex: 67-7452 "MARCORP"*

**MARKET**

March 29, 1982

United States Small Business Administration
Washington, D.C. 20416

ATTENTION: Arthur E. Armstrong, Director
Office of Special Guarantees

Dear Mr. Armstrong:

You have asked that we provide SBA with complete information regarding litigation or administrative proceedings involving the California Insurance Department, and Market Insurance Corporation including its principals or any other related entity, and particularly, how the unfavorable resolution of any of the issues would impact upon the ability of the parties mentioned to continue participation with SBA in the Surety Bond Guarantee Program.

First of all, let me state for the record that the California Insurance Department litigation and administrative proceedings involving Market Insurance Corporation and its principals has been dismissed by the California Insurance Department. Enclosed you will find a complete report from our attorney, prepared at our request, in which we asked that a report be prepared for fully disclosing what has occurred. In that regard be advised that "all licenses and rights under which Market Insurance Corporation functions as a managing general agent respecting participation in the SBA Program and otherwise, at all times has been, are now, and will continue to remain in full force and effect and Market's participation in the SBA Program will continue unaffected."

It has been most distressing to me that lies, misstatement, innuendo, and half-truths have been the basis of allegations about Market Insurance Corporation which simply are not true.

I hope you will completely read the enclosed report from our

**EXHIBIT B**

attorney. You will learn Market's administrative difficulties with the California Insurance Department were exactly the same as that encountered by one of the world's largest insurance organizations. You will also learn that the then Commissioner of the State of California thought that the fines of $25,000 levied in these matters "were so small".

Mr. Armstrong, I believe you are aware that Market Insurance Corporation wrote the first bond in the Small Business Administration Surety Bond Guarantee Program and during the years in which this program has grown to assist thousands of Small Business contractors, we have done our utmost to assist SBA and conductourselves in the highest tradition of the insurance and surety business, as well as complying with all laws and regulations to the best of our ability.

After you have read the information provided, I am sure you will come to the only reasonable conclusion possible -- that a terrible injustice has been done to Market Insurance Corporation and its principals.

Thank you for the opportunity to provide this information.

Very truly yours,

Arthur Bernstein

Arthur Bernstein
Chairman

AB/dz

Enclosure

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REPLY TO: BEVERLY HILLS
FILE NO:

March 29, 1982

United States Small Business Administration
Washington, D.C. 20416

Attention: Arthur E. Armstrong, Director
Office of Special Guarantees

Dear Mr. Armstrong:

We represent Market Insurance Corporation, Arthur Bernstein and Marvin Uritz as general counsel.

Our clients have received your letter inquiring into their involvement in "litigation or administrative proceedings" with the California Department of Insurance, and have asked that we fully advise you accordingly.

The litigation and administrative proceeding as respects Market Insurance Corp., Marvin Uritz, and Arthur Bernstein has been dismissed by the California Insurance Department. The matter is closed, and all licenses and rights under which Market Insurance Corporation functions as a managing general agent - respecting participation in the SBA program and otherwise, at all times have been, are now, and will continue to remain in full force and effect and Market's participation in the SBA program will continue unaffected.

By way of historical explanation, in August of 1977 and prior, the Statute, Section 1734 and 1735 of the California Insurance Code required a managing general agent, such as Market Insurance Corporation, to maintain premiums and return premiums on California business in an account or depository for the persons and companies respectively entitled thereto. Provided the managing general agent had the consent of its insurers, the managing general agent could make investments of premiums funds, such as in savings accounts or certificates of deposit. Market at all times relevant had such necessary authority from its insurers.

At this time - in 1977, it was common practice of managing general agents throughout California to maintain some premium and return premium funds in designated trust accounts which were repurchase securities and municipal bonds - investments which their principals, the insurers, were entitled to make under California law. In August of 1977, the Insurance Department of the State of California had never prohibited, through adminsitrative prosecution, this practice.

In accordance with all of the foregoing, with the consent of its insurers, Market Insurance Corporation had, as was customary with managing general agents throughout California, maintain some premiums on non-California insurance business in municipal bond and repurchase securities trust accounts.

When Market Insurance Corporation learned that the California Department of Insurance had charged two of the largest managing general agents (Swett and Crawford, and Sayre and Toso) with investing premium funds on California business in repurchase securities and municipal bonds, and despite the fact that the investments of Market Insurance Corporation had been made with respect to premiums on non-California business - as permitted by the Statute, out of an abundance of caution, it promptly divested itself of all such investments.

By reason of the fact that they chose not to contest the Insurance Department's interpretation of the statutes, two of the other managing general agents, previously identified as Swett and Crawford and Sayre and Toso, settled their administrative dispute with the Department of insurance upon payment of the requisite $25,000 fine. Enclosed is Exhibit A for your review, being a photocopy of the October 30, 1978 Insurance Journal, containing those pages of this California publication which reported on this matter.

It should be pointed out that these administrative "Catch-22's" are not an infrequent occurrance in State regulation. And even further, according to the then Commissioner Wesley Kinder of the California Insurance Department, fines in this case were perceived on the one hand as small, and on the other hand were designed to be warnings to the thousands of insurance agents in the State of California. Insurance industry executives have termed this practice "regulation by example".

For your further assistance, enclosed are photocopied pages from the 1981 Best's Insurance reports, which as you may know, is the recognized reporting service for the insurance industry. Exhibit B on Mission Insurance Company will reveal that the Mission Insurance Group not only includes nationally known Mission Insurance Company but also Sayre and Toso, the selfsame managing general agency which was the subject of the Commissioner's administrative proceeding like Market Insurance Corporation. Best reports that this company has over a half a billion dollars in admitted assets and did premium business during 1980 - $416,438,000 -

through the United States.

Also enclosed as Exhibit C, from Best's Insurance Reports is the report on Harbor Insurance Company, which upon careful reading will diclose that Harbor Insurance Company is under the direct financial control of Swett and Crawford and a member of the Swett and Crawford group, which in turn is a subsidiary of the Continental Corporation of New York.

Continental Corporation is comprised of more than 30 insurance companies, not counting myriad other related insurance agencies, brokerages, and other enterprises. We enclose for your further review, Exhibit D, Best's Insurance Reports on Continental Insurance Company which Best says is "one of the more prominent groups of insurance carriers in the world."

To the extent Sayre and Toso and Swett and Crawford "quickly" settled their administrative dispute with the California Insurance Department, although they also believed that no wrongdoing had occurred and Market sought vindication of its position, perhaps then Market's only error is one of integrity.

To return to our historical explanation, in the Summer of 1978, and completely "out of the blue", the Insurance Department, referring to an audit of Market Insurance Corporation which had been made as of December of 1977, but three months after Market no longer had them, suddenly raised the question of Market's trust accounts in repurchase securities and municipal bonds. In meetings between representatives of the Insurance Department and Market's attorneys, the statute permitting Market's conduct, the fact that the investments had been made with respect to non-California business, and the long standing custom in the industry were all referred to in conenction with the Department's inquiry. As a result of the meetings, it became apparent that the California Insurance Department was embarked on a course of "regulation by example", without reference to fairness, justice or equity.

In September of 1979, the Department of Insurance commenced an administrative proceeding against Market Insurance Corporation. In immediate response to the foregoing, Market sought before the Superior Court - and obtained - an injunction against any further proceedings by the Insurance Department.

In June of 1981, the Court, relying on the Insurance Department's "discretion" in such matters, denied the Application for Writ of Adminsitiative Mandamus and dissolved the injunction aginst the pending administrative proceeding against Market.

Faced with the prospect of a lengthy and expensive administrative hearing, and possibly an administrative appeal, although convinced of their eventual vindication, economic discretion being the better part of valor in these premises, our clients agreed to settle the administrative proceeding. The settlement terms - payment of a fine of $25,000 - were precisely consistent with the terms under which the Swett and Crawford, and Sayre and Toso, matters had been settled. The fine has been paid, the administrative proceeding has been dismissed by the Department; and as previously stated, the matter is closed, and all license and rights under which Market Insurance Corporation funds as a managing general agent - respecting participation in the SBA program, and otherwise, - at all times have been, are now, and will continue to remain in full force and effect and Market's participation in the SBA program will continue unaffected.

Separate, but interrelated to this problem, in August of 1977, Arthur Bernstein and Marvin D. Uritz, and American Business Corporation had filed applications with the California Department of Insurance for an organizational security permit and a certificate of authority to permit American Business Corporation (hereinafter "ABC") to be created, funded and authorized to act for a reciprocal insurance exchange (a form of insurance company) specifically to do a liquor liability insurance business.

In July of 1978, the Insurance Department suddenly denied the ABC application on the grounds of what it characterized as Market's unauthorized investments. It should be pointed out that Sayre and Toso and Swett and Crawford retained their insurance company rights intact, simply because it is far more difficult to take away rights previously granted, particularly when there is no basis for so doing.

Ironically, after four years, the business purpose for ABC has disappeared, nevertheless, the ABC matter is on appeal, to the Second Appellate District of the State of California's Court of Appeal. In so doing, Mr. Bernstein and Mr. Uritz seek justice and their rights preserved. Under the facts described, our clients are confident of prevailing, as are we.

To return to Market Insurance Corporation, a further ironic twist is the recent development of a new statute, enacted last year, Section 1734.5 of the California Insurance Code, which provides statutory confirmation that those selfsame trust account investments at issue here, repurchase securities, are specifically authorized, confirmation of Market's responsible financial conduct!

And in that regard, it should be further noted that the records of Market Insurance Corporation, as confirmed by the California Insurance Department's audit, show that Market always had sufficient funds to discharge its premium obligations, that not one penny was ever lost and at all times premium funds have been scrupulously accounted for!

For your further consideration, Mr. Armstrong, it is important to note that Mr. Uritz and Mr. Bernstein have over 60 years combined service to the insurance industry. During all that time in which they labored to earn the respect of their peers and build their business reputations, they conducted themselves legally and ethically in every way, so that they can look back on an unblemished record without conviction of any crime, big or small. Instead of the malicious, untrue accusations, please remember that it has been primarily because of the outstanding efforts of Mr. Bernstein that the SBA program has been at all successful in serving so many small business contractors over the years. The results of Mr. Bernstein's devotion to build interest and competence in this program is that the SBA program has performed a "valuable service" and that there continues to be a "real and fundamental need" for the program.

By reason of the foregoing, not only will Market Insurance Corporation's continued participation with the SBA in its Surety Bond Guarantee program continue as before, but also, we are confident that the rights of Mr. Uritz, Mr. Bernstein and American Business Corporation will ultimately be vindicated, and that Market Insurance Corporation's eighteen years of continuous and dedicated service to the community will continue and grow.

On behalf of our clients we wish to thank you for this long overdue opportunity to "set the record straight!"

Very truly yours,

MILLER AND DAAR

By______________________
G. FORSYTHE BOGEAUS

GFB/tlf

Enclosure: 1) Exhibit A - Insurance Journal Article of October 30, 1978
2) Exhibit B - RE: Sayre & Toso
3) Exhibit C - RE: Swett & Crawford
4) Exhibit D - RE: Swett & Crawford

# Insurance Dept. Pressures — Commissioner Speaks Out

By Mark Wells

California Insurance Commissioner Wesley J. Kinder believes that the insurance industry might well be regulated by both state and federal government by 1950. This is just one of many comments that Kinder made before the recent annual convention of the Independent Insurance Agents Association of California in Anaheim this month.

"I've commented on the threat of dual regulation, and suggested that it might well be a reality by 1980. I continue to believe that — not a certainty, mind you, but a very real possibility."

The remarks made the Commissioner were very forthright on what's happened and what's happening within the Department during his tenure in office. The following quotes and comments highlight those remarks.

### Growth

Kinder talked about the substantial growth of the Department over the last 10 years (from 302 employees in 1964 to a current roster of 400), which he attributed to the "substantive increases in liability insurance premiums of all kinds." Kinder praised the members of his staff saying, "The Department is made up of real people, not faceless bureaucrats."

### Demands Made

Kinder talked at length about the demands made upon the Department, not only by the day-to-day business that is required, but also by the legislature, the press and pressure groups such as the United Neighborhood Orgaization, the Chinese for Affirmative Action, La Raza Lawyers Association and others.

County and city demands also take a great deal of time, said Kinder. "The

Continued on page 4

# Dodd R. Young Elected IIAAC President 1978-79

Young

Dodd R. Young was elected President of the Independent Insurance Agents of California (IIAAC) at their annual convention in Anaheim. He has served this past year as vice president. Well known throughout the state, he is the past president of the Los Angeles Agents Association, and has chaired several state and national committees. He is the president of Rowan-Wilson Insurance Serivces.

Serving with Young are Arthur Samuel of Burlingame as vice president, Robert W. Carpenter of Merced as secretary-treasurer.

*CAARP Defeated*

# Assigned Risks — Equitable Pricing By Ins. Department

Insurance Commissioner Wesley J. Kidner released a decision aimed at more equitable pricing of car insurance.

The Commissioner said the decision, which directly affects the 250,000 motorist who must buy car insurance through the California Automobile Assigned Risk Plan (CAARP), is also intended to speed reforms now under way in the normal insurance market.

The decision, which answers a rate increase application filed by CAARP and follows four days of public hearing on that application,

— initiates a new system of "merit and demerit" rating in which assigned risk motorists with the worst driving record will pay as much as $200 a year more than those who have no accidents or traffic convictions;

— establishes premium rates which correspond with car accidents and traffic convictions on a zip code basis,

— ends what the Department has

Continued on page 22

INSURANCE JOURNAL

FIFTY-SEVENTH YEAR OCTOBER 30, 1978 NUMBER 21

# Swett & Crawford Revisited — Insurance Department Fines Sayre & Toso $25,000

By Karen St. George

It wasn't long ago that the insurance industry was shaken when the California Insurance Department levied a fine against Swett & Crawford for misuse of fiduciary funds. The Insurance Department has again demonstrated that it will uphold the Insurance Code by fining Sayre & Toso, the E&S brokerage arm of Mission Insurance Group, the sum of $25,000 also for misuse of fiduciary funds.

The *Insurance Journal* talked with Jason L. Katz, corporate counsel for Mission Insurance Group, about the fine. Katz said the "insurance Department was just doing its job," when it levied the fine, but he thought it was an arbitrary move on their part. Sayre & Toso, he said, was not given any warning that their trust accounts were in violation of the code. He said that there were no monies missing or misplaced.

The Insurance Code in California says that monies being held from insureds must be placed in a pass book account or a Certificate of Deposit (CD) bearing the legend "trust account." Sayre & Toso had not labeled some of their accounts correctly and also had some monies in commercial paper, which is also in violation of the Insurance Code.

Katz said he felt the Department was making an example of the big brokers when it fined first, Swett & Crawford, and then Sayre & Toso.

The *Insurance Journal* talked with California Insurance Commissioner Wesley J. Kinder on the recent fine, and asked him why his Department had not given warning to Sayre & Toso that their trust accounts were in violation of the Code. He said, "Wasn't Swett & Crawford a warning? We are just enforcing the Insurance Code. That's our job. The Department has several investigations going on at this time, and if we don't get any more, they alone will take 15 months to complete."

When asked if the Department was making an example of the big brokers, Kinder said, "First we're told that we are favoring the big brokers because we go after the little brokers. Now we're told it's the other way around. We can't seem to satisfy anyone."

Continued on page 4

EXHIBIT A

# Assigned Risks — Equitable Pricing

ntinued from page 1

ounty of Los Angeles, for their sidents, has petitioned the Department to find the practice of territorial ting to be unfairly discriminatory. he City of Los Angeles would have us lter the method of making commercial fire insurance rates to effect relief or the constituents."

Additional demands, said Kinder, ncluded assistance with respect to the ffordability/availability crunch, nonrofit activities and disaster center ctivities.

"The legislature," he said, "looks for dvice on the many insurance-related bills that come before them and re anxious for statistics on such classes as governmental liability and products liability insurance."

"The federal government," continued Kinder, "through an endless variety of congressional committees, administrative agencies and commissions, seeks information on subjects such as life insurance cost disclosure, medicare supplements, redlining, credit insurance, multiple employer trusts, and the effectiveness of state regulation."

Further, he said, California is being exposed to an extensive survey by the Government Accounting Office which has eaten up "dozens of hours."

### Media

The media also makes demands on the Department, said Kinder, for information on any "insurance-related activity and are frequently critical when the Department fails to provide the answer."

He said the traditional low profile that the Department has attempted to maintain has been swept away during the past two years and that a conscious effort to keep the press better informed has been made.

### Hinderences

Kinder then spoke about the various activities which have hindered the Department during his term as Commissioner.

Specifically he referred to the 1977 Auditor General's Report, which accused the Department of bias treatment. The Department was later exonerated through a public apology, but, said Kinder, "The great harm of the report can never be undone."

The Commissioner talked about legislative bills that have appeared before the California Congress which were directed against the Department. SB 5 would have extinguished the Insurance Department, and SB 1260 would have voided credit life and credit disability regulations prior to issuance by the Department. "The manner in which SB 5 was proposed suggested a pointed attack on the Department," said Kinder. He felt that SB 260 should not have happened. "If it (the legislature) wishes to withdraw that authority, it ought to be done directly," he said.

"The public, media, local governments, legislature and administration all seem to want more disclosure, more hard data to corroborate the need for the significantly higher liability insurance premiums. All expect the Department of Insurance to have it or to be able to get it on short notice. Everyone wants more," said Kinder.

### Cutbacks

With the effect of Proposition 13 Kinder said that his Department, while expected to do more each year, was told to cut back on spending. "If our budget is so limited that we cannot continue to do all that we are now doing, the first things sacrificed are the non-statutory activities." Never has so much been asked and expected, and never have the resources been so limited."

Kinder then referred to a recent options paper released by the Justice Department, which outlined five possible recommendations for the President's Commission on Anti-Turst's report to the insurance industry. "The options range," said Kinder, "from repeal of the industry's exemption under McCarran-Ferguson to continuing the present broad exemption." The Commission's final recommendations are due next January.

The five options studied in the paper include:

1) the recommendation of a dual charter for insurers, allowing them the option of operating under federal or state regulation;

2) repeal of the McCarran-Ferguson Act, with possible provision prohibiting states from regulating insurers in an anti-competitive manner;

3) a finding that there is not justification for the industry's continued broad antitrust exemption, and a recommendation of further study based on that finding;

4) the issuance of a policy statement recommending open competition, state regulation of insurance, and that courts interpret McCarran-Ferguson "more rigorously."

5) a recommendation that the present system remain unchanged, leaving states to choose their own method of insurance regulation.

Because of this option paper, and other instances over the last several years, Kinder believes that dual regulation is a very viable possibility.

### Auto Rate Guide

Kinder also reffered to a guide issued by the Department on car insurance premiums. "We believe that it is essential consumer information. Not the prices per se, but the fact that different companies have different prices. Our phones have been busy. Only one group, the largest, was critical of our work product — insurance agents. I'd like to say I was surprised, but it was about as expected," said Kinder.

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## Sayre & Toso Fined

Continued from page 1

### Banking Bill?

Katz indicated that banking interests were behind this particular section of the Code. "It's ridiculous that we are not allowed to place those funds in an investment with a higher return," said Katz. "In fact, some stock and certainly treasury bills, are better protected than the banks, which only guarantee monies up to $40,000."

Katz also complained about the law that requires all premiums paid on California-producing business to be kept in separate accounts in a California depository. "This has become a bookkeeping nightmare," said Katz. "It's against the law to co-mingle funds, which means that a multi-state company like Mission must have separate accounts for all of its out-of-state business," he said.

"This in turn," Katz said, "creates other problems such as, from which account do you draw on to pay expenses? And what happens if the premium for a multi-state risk is paid with one check?"

When asked why Sayre & Toso didn't challenge the fine, Katz said, "It wasn't economical. It would have cost us more in litigation than to pay the fine."

Katz said that if more of the big brokers were fined, that perhaps they would get together to challenge that section of the Code, but that currently, "the fines just aren't big enough to justify any action."

When Commissioner Kinder was asked why the fines were so small, he said, with a smile, "We would be happy to re-evaluate the matter, and perhaps come up with a bigger fine."

EXHIBIT A

## MISSION INSURANCE COMPANY

**Admin. Office:** 2600 Wilshire Boulevard
**Mail Address:** P.O. Box 60004
Los Angeles, Cal. 90060
**Telephone No.:** 213-381-6811
**Data Bank No.:** 02329

### ADMITTED ASSETS

| | Dec. 31, 1980 | Dec. 31, 1979 |
|---|---|---|
| Bonds: Amortized value | $325,811,249 | $302,261,431 |
| Stocks: Cost | (95,446,785) | (58,126,755) |
| Authorized value | 136,203,106 | 78,581,764 |
| Real estate: Cost | (12,639,849) | (10,668,922) |
| Carried at | 8,090,205 | 6,456,733 |
| Cash | 4,805,525 | 1,936,942 |
| Premium balances | 27,837,274 | 33,087,271 |
| Reinsurance recoverable | 8,479,750 | 9,186,664 |
| Accrued interest | 6,035,110 | 5,493,026 |
| Affiliated company balances | 31,098,668 | 4,765,902 |
| Association accounts | 2,320,324 | .... |
| EDP equipment | 1,462,731 | 1,612,541 |
| Other assets | 542,767 | 497,994 |
| Assets (statement) | $552,686,709 | $443,880,268 |

### LIABILITIES

| | Dec. 31, 1980 | Dec. 31, 1979 |
|---|---|---|
| Losses-adj. exp. reserves | $292,703,205 | $232,645,952 |
| Commissions | 1,059,562 | 726,442 |
| Expenses, taxes, etc. | 4,368,812 | 6,250,568 |
| Federal income taxes | 2,360,929 | 222,649 |
| *Unearned premiums | 47,272,421 | 44,061,393 |
| Dividends to stockholders | 1,265,000 | 475,000 |
| Dividends to policyholders | 9,493,754 | 5,672,035 |
| Reinsurance treaty funds | 7,862,041 | 8,579,142 |
| Loss drafts and balances | 537,049 | 585,895 |
| Payable securities transactions | 803,237 | 3,494,615 |
| Ceded reins. balances payable | 12,265,885 | 14,051,217 |
| Other liabilities | 6,311,648 | 6,209,709 |
| †Unauthorized reinsurance | 353,540 | .... |
| †Excess statutory loss reserve | 3,597,393 | 8,786,212 |
| Total Liabilities | $390,254,476 | $331,760,829 |
| Capital paid up | 2,000,000 | 2,000,000 |
| Net surplus | 160,432,233 | 110,119,439 |
| Total | $552,686,709 | $443,880,268 |

†Conditional Reserve Funds. See preface. *Includes for 1980 and 1979: rate and retrospective returns $1,862,356, $1,647,750.

### HISTORY

This company was incorporated in June 1948 under the laws of California as "Mission Indemnity Company." It was licensed June 13, 1952 with capital of $146,306 and a paid-in surplus of $119,608 (after organizational expenses) produced through the sale of shares at twice the par value of $1 each.

The present title was adopted on May 20, 1959.

Capital changes follow:

| Date | Capital Changes From | Capital Changes To | Surplus Contribution | Par Value | Issued Price |
|---|---|---|---|---|---|
| 1953-73 | $146,306 | $2,000,000 | A36,122,678 | A | A |
| 1974 | 2,000,000 | 2,000,000 | a5,000,000 | $800 | a |
| 1976 | 2,000,000 | 2,000,000 | b5,000,000 | 800 | b |
| 1977 | 2,000,000 | 2,000,000 | b14,000,000 | 800 | b |
| 1979 | 2,000,000 | 2,000,000 | 20,000,000 | 800 | .... |
| 1980 | 2,000,000 | 2,000,000 | c2,186,375 | 800 | .... |

(A) Alterations in capital structure marked. Sale of additional common and preferred shares, reduction and increase in par value of common shares, exercise of stock options, retirement of preferred shares, conversion of preferred shares, stock dividends, surplus contributions, including the outstanding shares of Holland-America Insurance Company, purchase of treasury stock, recapitalization via the exchange of 2,500 shares of $800 par value stock for 1,073,455 shares of $1 par value stock, and repayment of contribution certificates. Descriptive details are available upon request.

(a) Surplus contribution certificate bearing 12% interest. (b) Surplus contribution certificate bearing 9.25% interest. (c) Surplus contribution in the form of marketable securities.

Direct stock control of two former wholly-owned subsidiaries was transferred as surplus contribution on November 30, 1980 - ownership of Enterprise Insurance Company (formed in August 1978) to Holland-America Insurance Company, and the outstanding shares of Holland-America Insurance Company (acquired as a surplus contribution in December 1966) to Mission National Insurance Company. Ownership of the last named company was obtained, as a dividend, on the same date (November 30, 1980) from Holland-America Insurance Company.

Financial control is held by Mission Insurance Group, Inc. (known prior to May 20, 1977 as Mission Equities Corporation), which at the year end owned all of the outstanding capital shares. Also under the same financial sponsorship are Mission Re Management Corporation, Sayre and Toso, Inc., and Pacific Reinsurance Management Corporation of Los Angeles, Cal.; and George S. Kausler, Ltd., and Sayre and Toso, Inc. of Louisiana.

### MANAGEMENT

Management is headed by E. R. DeRosa and Belmont H. Teecher, chairman of the board and president, respectively. Both have been in the insurance field since the mid-forties. Also under the same general management are the affiliates, Mission National Insurance Company, and its subsidiary, Holland-America Insurance Company, which, in turn owns Enterprise Insurance Company and Pacific Reinsurance Company.

The five members of the Mission Insurance Group reported combined net premium writings of $332,545,000 in 1980. The year end consolidated assets and policyholders' surplus funds, of the group, were about $680,230,000 and $162,432,000, respectively.

Development of the Mission Insurance Group, in each of the last five years, has placed emphasis on commercial line underwriting, particularly workers compensation business in Ariz., Cal., Ga., N.Y. and Ore. Direct or originated premium writings, on a consolidated basis, for 1980 were $501,635,000 as compared with $125,335,000 in 1975. A similar trend was to be observed in the net or retained writings during this five-year interval.

Rewarding underwriting achievements accompanied the expansion program. The truly favorable operations enjoyed during the last half decade were evidenced by the annual indicated profit margins between range of 3.7% and 9.7%. Over the five years ended 1980, as a consequence, the working ratio averaged 93.0%, to provide a favorable underwriting balance of 7.0%. Dividend returns to policyholders were equal to 4.8% of earned premiums for the period.

Consolidated policyholders' surplus and special funds at the close of 1980 amounted to $167,420,000 as compared with $28,610,000 possessed at the start of 1976. Accretions to net resources over the past five years were principally due to investment gains and surplus contributions of $5,000,000 in 1976, $14,000,000 in 1977, $20,000,000 in 1979 and $2,186,375 in 1980.

Invested assets at the year end consisted primarily of a diversified portfolio of common and preferred stocks and bondholdings. The latter, mainly political subdivision and special revenue issues, were well distributed in modest-size blocks and equaled 85% of statement liabilities. Real estate, the home office property and other parcels of land in Los Angeles County, Cal., were carried at $8,090,206, or $1,708,399 less than cost (adjusted for incumbrances of $2,841,244). The stock portfolio, industrial common and utility preferred issues predominating, included the outstanding shares of Mission National Insurance Company, carried at $85,972,758.

An examination of the company's affairs is being made as of December 31, 1978 by the Insurance Departments of California, Delaware, Kansas, Missouri and Montana.

### BEST'S RATING

**Based on our analysis of the current financial and operating performance, we assign the company our Policyholders' Rating of "A+" (Excellent), which is a group rating assigned members of the Mission Insurance Group operating under a group business pooling arrangement. The financial size category is Class XV. See preface.**

**Classification of Admitted Assets.**—Bonds: U. S. Government, $518,405, 0.1%; state, municipal, etc., $107,953,986, 19.5%; special revenue $191,479,907, 34.6%; utility, $920,925, 0.2%; miscellaneous, $24,838,4[illegible], 4.5%; total bonds, $325,811,249, 59.0%; common stocks: railroad, $2,047,500, 0.4%; utility, $1,268,687, 0.2%; insurance, $2,[illegible]9,781, 0.5%; miscellaneous, $35,512,125, 6.4%; parents, subsidiaries, and affiliates $85,972,758, 15.6%; total common stocks, $127,370,851, 23.0%; preferred stocks: utility, $7,023,300, 1.3%; miscellaneous, $1,808,955, 0.3%; total preferred stocks, $8,832,255, 1.6%; real estate, $8,090,205, 1.5%; cash, $4,805,525, 0.9%; premium balances, $27,837,274, 5.0%; other assets $49,939,350, 9.0%.

### GENERAL UNDERWRITING POLICY

Underwriting facilities are maintained for the handling of virtually all forms of commercial property and casualty insurance. The company, however, in 1970 discontinued the writing of private passenger automobile coverages.

Underwriting acceptances in the workers compensation field, the company's specialty line, are concentrated mainly in southern and [illegible] western states. Policies are both on a participating and non-participating basis. All business is developed through approximately 1,200 agents and brokers.

The company and its subsidiaries (excluding Pacific Reinsurance Corporation) operate under an inter-company reinsurance agreement, originally

EXHIBIT B

## MISSION INSURANCE COMPANY—Continued

entered into on January 1, 1972, whereby all business acquired by the participants is pooled and the combined premiums distributed and losses and expenses prorated. The present participations in the pool are: Mission, 75%; Holland-America, 20%; Mission National, 2%; Enterprise, 3%. Previously, or before January 1, 1980, only the first three named carriers participated in the pooling arrangement with their shares being 75%, 23% and 2%, respectively. Prior to January 1, 1977, only the Mission and Holland-America participated in the pooling arrangement with their shares being 75% and 25%, respectively.

- Losses on casualty lines above $400,000 and on surplus lines over $150,000 are reinsured up to $15,000,000, per occurrence. Property claims over $200,000 ($100,000 on surplus lines are covered up to $10,000,000

Direct premium writings in 1980 were distributed in thousands as follows: Ala., 2,506; Alaska, 655; Ariz., 26,149; Ark., 785; Cal., 239,989; Colo., 3,035; Conn., 525; Del., 527; D.C., 324; Fla., 6,394; Ga., 8,126; Hawaii, 273; Idaho, 2,369; Ill., 4,367; Ind., 847; Iowa, 1,366; Kan., 1,705; Ky., 617; La., 10,018; Me., 275; Md., 616; Mass., 6,642; Mich., 1,801; Minn., 7,910; Miss., 1,674; Mo., 6,966; Mont., 1,047; Neb., 357; Nev., 1,159; N.H., 42; N.J., 4,585; N.M., 1,237; N.Y., 10,591; N.C., 943; N.D., 192; Ohio, 3,314; Okla., 1,890; Ore., 18,476; Pa., 7,374; R.I., 750; S.C., 749; S.D., 342; Tenn., 2,993; Texas, 10,378; Utah, 1,361; Vt., 44; Va., 305; Wash., 9,649; W. Va., 6; Wis., 1,910; Wyo., 176; P.R., 20; Can., 67; Foreign, 21.

### By-Line Underwriting Results

| | Workers Comp. | | | Auto Liability | | | Auto Physical | | |
|---|---|---|---|---|---|---|---|---|---|
| Year | *Prem. Earned | †Loss Ratio | †Exp. Ratio | *Prem. Earned | †Loss Ratio | †Exp. Ratio | *Prem. Earned | †Loss Ratio | †Exp. Ratio |
| 1976 | 53,087 | 74.9 | 17.5 | 2,871 | 96.4 | 25.9 | 1,149 | 70.6 | 26.7 |
| 1977 | 72,837 | 74.2 | 17.4 | 3,440 | 79.5 | 28.1 | 1,665 | 68.2 | 30.6 |
| 1978 | 96,265 | 73.1 | 18.0 | 10,674 | 89.0 | 19.9 | 2,501 | 74.4 | 25.3 |
| 1979 | 123,828 | 69.8 | 21.2 | 11,284 | 60.8 | 22.9 | 2,872 | 113.1 | 26.9 |
| 1980 | 142,358 | 62.7 | 19.0 | 8,471 | 71.7 | 29.1 | 3,205 | 117.1 | 29.7 |

*Last 000 omitted. †Losses and claim adj. expenses incurred to earned, underwriting expenses incurred to written.

**Territory.**—It is licensed in D.C. and all states.

**Officers.**—Chairman of the board, E. R. DeRosa; vice chairman of the board, L. F. Marioni; president, B. H. Teecher; executive vice president, Stanley Braun; senior vice presidents, John Dupuis, H. G. Suprenant, D. B. Zimmerman; vice president and treasurer, Richard F. Ting; vice presidents, John D. Beeks, M. J. Bonath, Joseph E. Collins, H. N. Gutman, K. O. Johnson, Jack D. Kiesler, M. A. Mulholland, M. V. O'Connell, William S. Pontius, A. C. Schuler, D. H. Willhite; secretary, W. A. Noll.

**Directors.**—E. M. Benson, Jr., E. R. DeRosa, Joseph M. Klein, Carl H. Lindner, L. F. Marioni, W. A. Noll, H. Safford Nye, Edward A. Smith, H. J. Toso, M. van Hengel.

### 1980 Premiums—Losses

| Kinds of Insurance | *Direct Premiums Written | *Net Premiums Written | *Case Loss & Exp. Res. Year-End | *Net Premiums Earned | ‡Pure Loss Ratio 1980 | 1979 |
|---|---|---|---|---|---|---|
| Fire | $8,435 | $2,195 | $1,211 | $2,052 | 105.0 | 95.2 |
| Com'l Multi Peril | 48,318 | 29,134 | 27,980 | 31,095 | 62.1 | 62.8 |
| Inland Marine | 56,659 | 4,334 | 2,816 | 2,767 | 471.8 | 50.2 |
| Workers Compensation | 167,401 | 144,717 | 162,172 | 142,358 | 54.7 | 62.4 |
| Misc. Liability | 106,593 | 44,386 | 64,269 | 43,816 | 52.4 | 48.4 |
| Auto Liability | 10,201 | 8,879 | 16,422 | 8,471 | 5[illegible].7 | 56.8 |
| Auto Physical | 3,914 | 3,423 | 2,675 | 3,205 | 99.2 | 106.5 |
| Reinsurance | . . . | 7,401 | 13,572 | 7,585 | 70.3 | 69.3 |
| All Other | 14,918 | a1,804 | 1,565 | 1,700 | . . . | . . . |
| Totals | $416,438 | $246,262 | $292,703 | $243,051 | 57.8 | 60.8 |

*Figures in thousands. ‡Incurred to earned premiums. (a) Distribution in dollars: Allied lines, 176,783, homeowners, 44,143, ocean marine, 390,019, medical malpractice, 3,595, earthquake, 105,708, aircraft (all perils), 6,274, fidelity, 366, surety, 12,810, glass, -1,513, burglary & theft, 283,335, boiler & machinery, 1,484, credit, 2,037, miscellaneous, 129,069.

### Underwriting Income and Disbursements, 1980

| | |
|---|---|
| Premiums written: Direct, $416,438,078, reinsurance assumed, $98,613,473, reinsurance ceded, $268,789,322, net | $246,262,229 |
| Losses paid: Direct, $160,894,568; reinsurance assumed, $23,252,760, reinsurance recovered, $98,150,205, net | $85,997,123 |
| Loss adjustment expenses paid | $15,492,091 |
| Underwriting expenses incurred—Commissions: Direct, $70,756,054, reinsurance assumed, $16,936,468; reinsurance ceded, $57,824,141; contingent, $126,000, commissions—net, $30,024,381, salaries, $9,993,072, taxes, licenses, fees, $9,253,883; all others, $9,241,381; total | $58,512,717 |

### Underwriting Account, 1980, before Federal Taxes

| Gains: | | Losses: | |
|---|---|---|---|
| Prems. earned | $243,051,201 | Losses inc'd | $140,586,983 |
| Fin. & svc. chgs. | 181,671 | Adj. exp. inc'd | 20,959,484 |
| | | Und. exp. inc'd | 58,512,717 |
| | | Und. gain | 23,173,688 |
| Total | $243,232,872 | Total | $243,232,872 |

### Investment Account, 1980, before Federal Taxes

| Gains: | | Losses: | |
|---|---|---|---|
| Inv. income | $25,359,538 | Inv. exp. inc'd | $1,290,037 |
| Appreciation | 20,301,314 | Inv. gain | 46,538,624 |
| Sales | 176,608 | | |
| Adj. in book value | 1,991,201 | | |
| Total | $47,828,661 | Total | $47,828,661 |

### Policyholders' Surplus Account, 1980

| Additions: | | Deductions: | |
|---|---|---|---|
| Pol. sur. 1979 | $112,119,439 | Federal inc. tax | $3,506,929 |
| Und. gain | 23,173,688 | Assets non-ad. | 5[illegible]322 |
| Inv. gain | 46,538,624 | Unauth. reins. | 35[illegible]540 |
| Loss res. adj. | 5,188,819 | Div. stockholders | 3,818,000 |
| Surplus paid-in | 2,186,375 | Div. plyhldrs. | 16,517,458 |
| | | Interest certif. | 1,795,000 |
| | | Other items | 246,462 |
| | | Pol. sur. 1980 | 162,432,233 |
| Total | $189,206,945 | Total | $189,206,945 |

## COMPARATIVE FINANCIAL AND OPERATING EXHIBIT

All figures except ratios in thousands

| | Asset % | | FINANCIAL | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| Year | Cash & Bonds | Stock | Total Admitted Assets | Reported Policyholders' Surplus | Special Funds | Case Loss Reserves | Unearned Prems. | Direct Prems. Written | Net Prems. Written |
| 1976 | 59 | 21 | 144,080 | 43,065 | 2,373 | 72,776 | 13,182 | 157,609 | 80,291 |
| 1977 | 68 | 18 | 216,361 | 58,923 | 6,513 | 105,847 | 22,468 | 229,820 | 121,196 |
| 1978 | 71 | 16 | 305,931 | 67,764 | 9,130 | 159,615 | 34,390 | 327,029 | 176,370 |
| 1979 | 69 | 18 | 443,880 | 112,119 | 8,786 | 232,646 | 44,061 | 393,352 | 225,956 |
| 1980 | 60 | 25 | 552,687 | 162,432 | 3,951 | 292,703 | 47,272 | 416,438 | 246,262 |
| Totals and Averages | | | | | | | | 1,524,249 | 850,104 |

| | OPERATING—Before Federal Taxes | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| Year | Net Prems. Earn. | Losses Inc. to Prems. Earn. | Exp. Inc. to Prems. Writ. | Comb. Loss and Exp. | Underwriting Profit or Loss | Net Investment Income | Other Invest. Gains or Losses | Federal Taxes Incurred | Dividends Declared |
| 1976 | 78,049 | 75.3 | 21.1 | 96.3 | 2,291 | 5,235 | 6,638 | -101 | p<br>1,650 |
| 1977 | 111,910 | 72.0 | 22.2 | 94.2 | 4,522 | 7,287 | -150 | 563 | 3,438 |
| 1978 | 164,458 | 71.4 | 22.6 | 94.0 | 7,297 | 11,500 | 3,736 | 308 | 7,246 |
| 1979 | 216,304 | 69.3 | 24.1 | 93.4 | 12,094 | 18,633 | 10,012 | 1,223 | 12,203 |
| 1980 | 243,051 | 66.5 | 23.8 | 90.2 | 23,174 | 24,070 | 22,469 | 3,506 | 20,335 |
| | 813,772 | 69.8 | 23.1 | 93.0 | 49,378 | 66,725 | 42,705 | 5,498 | 44,873 |

(p) Includes dividends to stockholders: 1978, $400,000; 1979, $1,475,000; 1980, $16,517,458; balance to policyholders.

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## COMPARATIVE FINANCIAL AND OPERATING EXHIBIT

All figures except ratios in thousands

FINANCIAL

| | | | Total Admitted Assets | Reported Policy-holders' Surplus | Special Funds | Case Loss Reserves | Un-earned Prems. | Direct Prems. Written | Net Prems. Written |
|---|---|---|---|---|---|---|---|---|---|
| [illegible] | 95 | 1 | 177,829 | 39,728 | 190 | 116,913 | 18,841 | 312 | 111,099 |
| [illegible] | 96 | 1 | 237,139 | 50,999 | 908 | 147,699 | 26,553 | . . . | 130,326 |
| [illegible] | 91 | 2 | 314,481 | 63,039 | 1,515 | 206,171 | 37,096 | . . . | 174,241 |
| [illegible] | 94 | 2 | 407,418 | 82,629 | 991 | 246,925 | 44,530 | . . . | 191,778 |
| [illegible] | 88 | 2 | 483,699 | 96,728 | 946 | 290,012 | 39,509 | . . . | 188,417 |
| Totals and Averages | | | | | | | | 312 | 795,861 |

OPERATING—Before Federal Taxes

| | Net Prems. Earn. | Losses Inc to Prems. Earn. | Exp Inc to Prems. Writ. | Comb. Loss and Exp. | Under-writing Profit or Loss | Net Invest-ment Income | Other Invest. Gains or Losses | Federal Taxes Incurred | Divi-dends De-clared |
|---|---|---|---|---|---|---|---|---|---|
| [illegible] | 97,040 | 82.8 | 22.6 | 105.4 | -8,436 | 11,271 | 264 | . . . | . . . |
| [illegible] | 122,614 | 74.0 | 28.5 | 102.5 | -5,298 | 16,820 | 34 | . . . | . . . |
| [illegible] | 163,698 | 83.5 | 22.1 | 105.6 | -11,500 | 22,765 | 418 | . . . | . . . |
| [illegible] | 184,344 | 85.6 | 23.6 | 109.1 | -18,590 | 31,261 | 1,051 | . . . | . . . |
| [illegible] | 193,437 | 76.7 | 29.5 | 106.2 | -10,541 | 43,772 | 1,408 | -1,274 | . . . |
| | 761,134 | 80.6 | 25.3 | 106.0 | -54,363 | 125,890 | 3,175 | -1,274 | . . . |

◆

## HARBOR INSURANCE COMPANY

ome Office: 4201 Wilshire Boulevard
ail Address: P.O. Box 54201
Los Angeles, Cal. 90054
elephone No.: 213-937-5411
ata Bank No.: 00454

### ADMITTED ASSETS

| | Dec. 31, 1980 | Dec. 31, 1979 |
|---|---|---|
| ods: Amortized value | $[illegible],364,587 | $81,445,751 |
| cks: Cost | ([illegible]6,785,066) | (73,607,077) |
| Authorized value | [illegible]0,999,163 | 70,974,539 |
| al estate: Cost | (8,980,100) | (11,890,031) |
| Carried at | 1,651,653 | 1,566,732 |
| sh | 10,567,336 | 3,328,089 |
| mium balances | 8,387,526 | 10,989,624 |
| nds dep. with reinsured cos. | 1,853,573 | 1,695,251 |
| nsurance recoverable | 4,966,158 | 7,221,646 |
| crued interest | 1,815,960 | 1,040,739 |
| filiated company balances | 892,328 | 717,008 |
| c. security transactions | 371,919 | . . . . |
| P equipment | 214,406 | 272,870 |
| Assets (statement) | $222,084,609 | $179,252,249 |

### LIABILITIES

| | Dec. 31, 1980 | Dec. 31, 1979 |
|---|---|---|
| sses-adj. exp. reserves | $83,118,277 | $71,179,352 |
| mmissions | . . . . | 50,000 |
| penses, taxes, etc. | 997,363 | 812,040 |
| deral income taxes | 10,100,000 | 2,712,269 |
| terest payable | 12,667,435 | . . . . |
| earned premiums | 17,553,315 | 19,280,121 |
| insurance treaty funds | 512,592 | 527,569 |
| Amount held for others | 1,302,345 | 453,340 |
| ns drafts and balances | 921,812 | 1,123,765 |
| oled reins. balances payable | 4,373,654 | 6,081,656 |
| nauthorized reinsurance | 1,104,473 | 206,704 |
| cess statutory loss reserve | . . . . | 1,401,362 |
| Total Liabilities | $132,651,266 | $103,828,178 |
| tal paid up | 2,000,000 | 2,000,000 |
| surplus | 87,433,343 | 73,424,071 |
| Total | $222,084,609 | $179,252,249 |

†Conditional Reserve Funds. See preface.

### HISTORY

This company was incorporated on February 18, 1946 under the laws of California and was licensed May 1 of the same year. It began business May 4, 1946 with a capital of $150,000 and a surplus of $180,000. Original stock, $10 par value, was sold at $22 per share.

Capital changes follow:

| Date | Capital Changes From | Capital Changes To | Surplus Contribution | Par Value | Issued Price |
|---|---|---|---|---|---|
| 1947-74 | $150,000 | $1,650,000 | A$15,262,305 | A | A |
| 1975 | 1,650,000 | 2,000,000 | . . . . | Stock | Dividend |
| 1976 | 2,000,000 | 2,000,000 | 10,220,177 | $5 | . . . . |
| 1977 | 2,000,000 | 2,000,000 | 10,000,000 | 5 | . . . . |
| 1978 | 2,000,000 | 2,000,000 | 15,000,000 | 5 | . . . . |

(A) Alterations in capital structure marked. Sale of preferred and common shares; a stock split; shares issued in exchange for shares of New Harbor, Inc.; acquisition of treasury shares, surplus contributions, and stock dividends. Descriptive details are available upon request.

The capital structure at the year end consisted of 399,940 common shares (including 100,682 treasury shares) of $5 par value each, and 30 shares (all held as treasury stock) of $10 par value non-voting, non-dividend preferred stock, redeemable at $100,000 per share.

Ownership of a former wholly-owned affiliate, Cypress Insurance Company, on December 31, 1976 was passed via a dividend to Swett & Crawford, and then to its former parent, Unionamerica, Inc. (now known as Westmor Corporation). Another former subsidiary, Buffalo Reinsurance Company, was sold on August 1, 1979 to the companion carrier, Firemen's Insurance Company of Newark, N.J.

Direct financial control has resided since July 1959 with Swett & Crawford, prominent underwriting managers located in Los Angeles, Cal. The latter, in turn, on December 31, 1976 became a subsidiary of The Continental Corporation, New York, N.Y. Ownership was purchased from Unionamerica, Inc., Los Angeles, Cal., a holding company, which, on April 18, 1969, acquired financial control of Swett & Crawford.

### MANAGEMENT

No change in general management or underwriting philosophy accompanied the late 1976 transfer of ownership of the parent company. Operations of the Swett & Crawford Group, of which this company and its subsidiary, Pacific Insurance Company, are members, are conducted independently from other members of The Continental Insurance Companies. Managerial affairs are under the guidance of experienced insurance executives headed by Charles L. Norman, named president in April 1980. He has served the company in an executive capacity for many years—most recently (since 1971) as executive vice president.

Joint administrative offices are maintained with the Buffalo Reinsurance Company (acquired in 1971 and sold in 1979), Pacific Insurance Company (licensed in 1979) and the parent organization, Swett & Crawford. The last-named organization has offices in major cities of the United States and is one of the larger correspondents of Lloyd's of London.

Operations are conducted in the multiple line field with efforts concentrated on the underwriting of industrial, commercial and contracting risks.

Direct or originated premium production has been relatively stable over the last five years ranging from a low of $71,646,000 (in 1976) to a high of $99,062,000 (in 1978). Net or retained writings over the same interval were more modest and developed a similar trend. Such writings ranged between $36,441,000 and $39,925,000, or an annual average of just under $36,600,000 for the period.

Underwriting operations developed rewarding results in each of the last four years as evidenced by a mean indicated favorable balance of 1.6% of premiums. These results and the much improved but still unrewarding experience in 1976 (a working ratio of 104.4%) reflected the benefits of corrective measures initiated by management earlier to correct unusually poor experience under general and automobile liability and ocean marine.

Policyholders' surplus and special reserve funds at year end were $90,538,000 as compared with $20,692,000 on December 31, 1975. Additions to free resources reflected investment gains and the surplus contributions of $10,220,000 in 1976, $10,000,000 in 1977; and $15,000,000 in 1978. Marked improvement as a result of the infusion of capital funds has established a reasonable relationship between the present level of underwriting commitments and net resources available to meet contingencies in the light of standards normally prevailing in the insurance industry and with respect to the classes of risks underwritten.

A sound and diversified investment portfolio is maintained. Cash and bondholdings, principally political subdivision, special revenue and corporate issues, were equal to over three-fourths of reported liabilities. The stock portfolio, another 45% of total assets, included holdings in affiliates: 100,000 shares of Pacific Insurance Company at $10,877,387, and 1,640,000 shares of Unionamerica Insurance Company, Ltd., at $4,530,416. Other large equity investments (with a year end market value over $4,000,000) were: 112,600 Eastman Kodak Co.; 200,000 Manufacturers Hanover Corp., 82,200 J. P. Morgan & Co., and 68,800 Shell Oil Co. Real estate is home office property carried at $1,566,732 compared with cost of $8,980,100 (subject to an encumbrance of $6,085,835).

EXHIBIT C

## HARBOR INSURANCE COMPANY—*Continued*

An examination of the company's affairs was made as of December 31, 1979 by the Insurance Departments of California, Delaware, Oregon and Tennessee.

### BEST'S RATING

**Based on our analysis of the current financial and operating performance, we assign the company our Policyholders' Rating of "A+" (Excellent), which is a group rating assigned members of the Swett & Crawford Group operating under a group business pooling arrangement. The financial size category is Class XIV. See preface.**

Classification of Admitted Assets.—Bonds: U. S. Government, $1,211,475, 0.5%; state, municipal, etc., $23,141,450, 10.4%; special revenue, $34,852,457, 15.7%; miscellaneous, $31,159,205, 14.0%; total bonds, $90,364,587, 40.7%; common stocks: utility, $3,114,280, 1.4%; bank, $13,193,429, 5.9%; miscellaneous, $46,115,434, 20.8%; parents, subsidiaries, and affiliates, $15,407,803, 6.9%; total common stocks, $77,830,946, 35.0%; preferred stocks: utility, $19,691,767, 8.9%; miscellaneous, $3,476,450, 1.6%; total preferred stocks, $23,168,217, 10.4%; real estate, $1,651,653, 0.7%; cash, $10,567,336, 4.8%; premium balances, $8,387,526, 3.8%; other assets, $10,114,344, 4.6%.

### GENERAL UNDERWRITING POLICY

Underwriting activities embrace the handling of general property and casualty lines in the commercial, industrial and construction fields at independently filed rates. Underwriting commitments comprising risks located in California (or developed through brokers of that state) have diminished over the past several years to the point where such acceptances are less than 40% of premium income.

The company, in addition, assumes most of the direct business written by the companion, Buffalo Reinsurance Company. Treaty and facultative reinsurance assumptions from other carriers are generally retroceded to the Buffalo Reinsurance Company.

Management, effective January 1, 1980, entered into an inter-company reinsurance arrangement, whereby all business acquired by the company and its affiliate, Pacific Insurance Company, is pooled, the combined premiums distributed and losses and expenses prorated. The participations are Harbor Insurance Company, 90%, and Pacific Insurance Company, 10%.

Casualty reinsurance on direct business is placed primarily with domestic carriers and affords recovery of all losses above $100,000 up to $10,000,000. Property reinsurance is handled partly on a surplus and partly on an excess of loss basis with an automatic limit of up to $4,000,000; catastrophe covers on direct and assumed business (including automobile physical damage) are also maintained. Treaty reinsurance assumptions are written on a net line basis. Facultative reinsurance acceptances are subject to limits of $2,000,000 on property and casualty risks and retrocessions are placed principally with domestic carriers.

Direct premium writings in 1980 were distributed in thousands as follows: Ala., 247; Alaska, 22; Ariz., 1,179; Ark., 86; Cal., 22,428; Colo., 453; Conn., 326; Del., 195; D.C., 1,743; Fla., 1,036; Ga., 1,998; Hawaii, 578; Idaho, 472; Ill., 2,963; Ind., 804; Iowa, 402; Kan., 398; Ky., 183; La., 1,698; Md., 1,242; Mass., 726; Mich., 1,866; Minn., 1,125; Miss., 182; Mo., 1,065; Mont., 141; Neb., 307; Nev., 321; N.H., 157; N.J., 1,037; N.M., 446; N.Y., 189; N.C., 1,014; N.D., 66; Ohio, 2,082; Okla., 1,496; Ore., 2,217; Pa., 1,215; S.C., 514; S.D., 20; Tenn., 422; Texas, 6,619; Utah, 829; Vt., 59; Va., 5,501; Wash., 2,191; W. Va., 226; Wis., 1,044; Wyo., 191; Foreign, -3.

#### By-Line Underwriting Results

| | §Misc. Liability | | | Auto Liability | | |
|---|---|---|---|---|---|---|
| Year | *Prem Earned | †Loss Ratio | †Exp Ratio | *Prem Earned | †Loss Ratio | †Exp Ratio |
| 1976 | 13,397 | 94.5 | 29.7 | 2,569 | 68.2 | 26.8 |
| 1977 | 20,440 | 67.7 | 28.6 | 2,880 | 51.9 | 27.0 |
| 1978 | 23,719 | 64.1 | 26.2 | 2,804 | 61.9 | 26.2 |
| 1979 | 25,679 | 62.1 | 32.8 | 3,672 | 62.2 | 27.6 |
| 1980 | 23,370 | 68.8 | 34.9 | 2,032 | 30.7 | 18.8 |

*Last 000 omitted. †Losses and claim adj. expenses incurred to earned, underwriting expenses incurred to written. §Includes medical malpractice.

Territory.—It is licensed in D.C. and all states except Ark., Conn., Kan., Me., Mass., N.H., N.J., N.Y., N.D., R.I., S.C., S.D. and Vt. It is also licensed in Guam, Belgium and Holland.

Officers.—President, Charles L. Norman; executive vice presidents, Eugene L. Allen, Edwin V. Hughes; senior vice president and secretary, Harry D. Boyd; senior vice presidents, Nino D. Crisafulli, Thomas M. McHugh, Michael Stoddard, W. Hall Wilson; vice presidents, Vern W. Huddleston, Edward J. Jamison, Jr., Brian F. Johnston, Edward McKinnon, John P. Viescas; vice president and treasurer, Joel G. Eckner.

Directors.—Eugene L. Allen, Harry D. Boyd, Joel G. Eckner, Mac W. Henderson, Edwin V. Hughes, Charles L. Norman.

#### 1980 Premiums—Losses

| Kinds of Insurance | *Direct Premiums Written | *Net Premiums Written | *Case Loss & Exp. Res. Year-End | *Net Premiums Earned | ‡Pure Loss Ratio 1980 |
|---|---|---|---|---|---|
| Fire | $4,912 | $1,341 | $678 | $1,785 | 49.3 |
| Allied Lines | 2,336 | 497 | 910 | 856 | 35.7 |
| Inland Marine | 13,191 | 1,558 | 1,807 | 1,739 | 127.2 |
| Misc. Liability | 46,689 | 23,231 | 70,229 | 23,371 | 49.7 |
| Auto Liability | 3,028 | 1,970 | 5,326 | 2,033 | 12.3 |
| Auto Physical | 765 | 651 | 220 | 591 | 54.9 |
| All Other | 801 | a335 | 3,948 | 935 | ... |
| Totals | $71,721 | $29,583 | $83,118 | $31,309 | 51.0 |

*Figures in thousands. ‡Incurred to earned premiums. (a) Distribution in dollars: Com'l multi peril, 132,299; ocean marine, 63,820; earthquake, 51,368; group a&h, 26,006; workers comp., 11,888; aircraft (all perils), 10,038; fidelity, 7,494; glass, 3,158; burglary & theft, 31,720; international, -3,206.

#### Underwriting Income and Disbursements, 1980

| | |
|---|---|
| Premiums written: Direct, $71,721,070; reinsurance assumed, $8,690,205; reinsurance ceded, $50,828,586; net | $29,582,689 |
| Losses paid: Direct, $41,705,709; reinsurance assumed, $5,842,981; reinsurance recovered, $41,868,469; net | $5,680,221 |
| Loss adjustment expenses paid | $4,040,596 |
| Underwriting expenses incurred—Commissions: Direct, $12,825,332; reinsurance assumed, $1,653,478; reinsurance ceded, $9,297,019; contingent, $114,907; commissions—net, $5,296,698; salaries, $2,025,509; taxes, licenses, fees, $2,134,156; all others, $-868,074; total | $8,588,289 |

#### Underwriting Account, 1980, before Federal Taxes

| Gains: | | Losses: | |
|---|---|---|---|
| Prems. earned | $31,309,495 | Losses inc'd | $15,978,683 |
| P & L items | 400,000 | Adj. exp. inc'd | 5,681,059 |
| | | Und. exp. inc'd | 8,588,289 |
| | | Und. gain | 1,461,464 |
| Total | $31,709,495 | Total | $31,709,495 |

#### Investment Account, 1980, before Federal Taxes

| Gains: | | Losses: | |
|---|---|---|---|
| Inv. income | $15,867,748 | Inv. exp. inc'd | $1,471,288 |
| Appreciation | 7,219,807 | Inv. gain | 22,849,915 |
| Sales | 1,233,648 | | |
| Total | $24,321,203 | Total | $24,321,203 |

#### Policyholders' Surplus Account, 1980

| Additions: | | Deductions: | |
|---|---|---|---|
| Pol. sur. 1979 | $75,424,071 | Federal inc. tax | $10,758,431 |
| Und. gain | 1,461,464 | Unauth. reins. | 897,769 |
| Inv. gain | 22,849,915 | Other items | 47,269 |
| Loss res. adj. | 1,401,362 | Pol. sur. 1980 | 89,433,343 |
| Total | $101,136,812 | Total | $101,136,812 |

#### COMPARATIVE FINANCIAL AND OPERATING EXHIBIT

All figures except ratios in thousands

| | Asset % | | FINANCIAL | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| Year | Cash & Bonds | Stock | Total Admitted Assets | Reported Policyholders' Surplus | Special Funds | Case Loss Reserves | Unearned Prems | Direct Prems. Written | Net Prems. Written |
| 1976 | 60 | 11 | 113,797 | 26,556 | 527 | 61,113 | 13,897 | 71,646 | 38,442 |
| 1977 | 68 | 14 | 139,127 | 41,538 | 1,143 | 69,884 | 15,413 | 98,439 | [illegible] |
| 1978 | 61 | 25 | 160,157 | 60,944 | 7,564 | 64,210 | 17,258 | 99,062 | [illegible] |
| 1979 | 47 | 40 | 179,252 | 75,424 | 1,608 | 71,179 | 19,280 | 79,636 | [illegible] |
| 1980 | 45 | 45 | 222,085 | 89,433 | 1,104 | 83,118 | 17,553 | 71,721 | [illegible] |
| Totals and Averages | | | | | | | | 420,504 | [illegible] |

| | OPERATING—Before Federal Taxes | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | Net Prems. Earn. | Losses Inc. to Prems. Earn. | Exp. Inc. to Prems. Writ. | Comb. Loss and Exp. | Under-writing Profit or Loss | Net Invest-ment Income | Other Invest. Gains or Losses | Federal Taxes Incurred | Divi-dends De-clared |
| '6 | 39,148 | 83.4 | 20.9 | 104.4 | -1,565 | 2,327 | 147 | -520 | a5,404 |
| '77 | 37,016 | 76.2 | 22.8 | 99.0 | 24 | 4,655 | 826 | . . . | . . . |
| '8 | 34,596 | 70.8 | 28.0 | 98.8 | -110 | 6,341 | 5,127 | 725 | . . . |
| '9 | 37,903 | 70.8 | 27.0 | 97.8 | 295 | 9,078 | 2,503 | 2,285 | 1,300 |
| '0 | 31,307 | 69.2 | 29.0 | 98.2 | 1,461 | 14,396 | 8,453 | 10,758 | . . . |
| | 179,973 | 74.4 | 25.4 | 99.7 | 106 | 36,997 | 17,055 | 13,248 | 6,704 |

(a) Dividend in form of securities

Capital changes follow:

| Date | —Capital Changes— From | To | Surplus Contribution | Par Value | Issued Price |
|---|---|---|---|---|---|
| 1955-72 | $250,000 | $1,500,000 | A-$1,526,621 | A | A |
| 1975 | 1,500,000 | 1,700,000 | . . . . | a$7 | . . . . |
| 1977 | 1,700,000 | 2,000,000 | . . . . | a10 | . . . . |
| 1977 | 2,000,000 | 2,000,000 | 2,000,000 | 10 | . . . . |
| 1979 | 2,000,000 | 2,000,000 | . . . . | b10 | . . . . |
| 1979 | 2,000,000 | 2,000,000 | . . . . | c | c |

(A) Alterations in capital structure marked. Sale of new common and preferred shares and return of surplus funds. Descriptive details are available upon request. (a) Par value of common shares increased (from $5 to $7 each in 1975 and from $7 to $10 each in 1977). (b) Par value of preferred shares increased from $5 to $10 by means of a reverse 2 for 1 stock split. (c) Recalled and cancelled 80,000 common shares and issued in exchange a like amount of preferred shares.

Present outstanding capital comprises 180,000 non-cumulative, $0.80 dividend preferred shares and 20,000 common shares. Both issues have a par value of $10 each.

Operations of the company were conducted under the title "Washington General Insurance Corporation" from organization until March 6, 1973 when the present corporate name was adopted.

Administrative offices were moved in early 1973 to Chicago, Ill., and to Milwaukee, Wis., in mid-1973.

Direct stock ownership in 1973 passed to Association Life Insurance Company, Milwaukee, Wis., from its parent organization, International Harvester Company, Chicago, Ill. The latter, in turn, on December 28, 1972 had acquired complete stock ownership of the company from the Firemen's Insurance Company of Newark, New Jersey (an affiliate of The Continental Corporation, New York, N.Y.) through an exchange of shares. The Firemen's obtained its stock interest in early 1966 when it purchased all of the outstanding shares of Appleton & Cox, Inc., the original sponsors.

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## HARCO NATIONAL INSURANCE COMPANY

### Albany, New York

ome Office: 749 North Second Street
ail Address: P.O. Box 8-B
Milwaukee, Wis. 53201
elephone No.: 414-276-8000
ata Bank No.: 00960

### ADMITTED ASSETS

| | Dec. 31, 1980 | Dec. 31, 1979 |
|---|---|---|
| onds: Amortized value | $24,342,493 | $30,940,338 |
| ocks: Cost | (4,391,368) | (4,391,369) |
| Authorized value | 2,842,323 | 3,442,197 |
| ollateral loans | 500,000 | 2,575,000 |
| ash | 2,135,493 | 1,908,352 |
| remium balances | 2,440,242 | 1,641,870 |
| unds dep. with reinsured cos. | 5,361,713 | . . . . |
| einsurance recoverable | 136,744 | 255,867 |
| Accrued interest | 719,214 | 689,519 |
| ffiliated company balances | 118,195 | 925,000 |
| Assets (statement) | $38,596,417 | $42,378,143 |

### LIABILITIES

| | Dec. 31, 1980 | Dec. 31, 1979 |
|---|---|---|
| osses-adj. exp. reserves | $4,514,000 | $4,431,104 |
| xpenses, taxes, etc. | 315,161 | 440,962 |
| Federal income taxes | 286,586 | 273,012 |
| nearned premiums | 21,638,036 | 26,970,649 |
| Affiliated company balances | 579,674 | 192,088 |
| Loss drafts and balances | 1,001,505 | 728,888 |
| Ceded reins. balances payable | 1,022,880 | 946,962 |
| Other liabilities | 27,384 | 182,287 |
| †Excess statutory loss reserve | 218 | 2,460 |
| Total Liabilities | $29,385,444 | $34,168,412 |
| Capital paid up | 2,000,000 | 2,000,000 |
| Net surplus | 7,210,973 | 6,209,731 |
| Total | $38,596,417 | $42,378,143 |

†Conditional Reserve Funds. See preface.

### HISTORY

This company was incorporated on November 17, 1954 under the laws of the State of New York. It was licensed December 27 of the same year with paid-in capital of $250,000 and contributed surplus of a like amount. All issued stock, 50,000 shares of a par value of $5 each, was purchased by Appleton & Cox, Inc. The company commenced business January 1, 1955.

### MANAGEMENT

Present management has governed the affairs of the company since the December 1972 change in financial control. The parent organization, International Harvester Company, is one of the larger multi-national firms engaged in producing trucks, agricultural, construction and industrial equipment.

Administration of affairs and the conduct of insurance operations is under the direction of W. Stanley Pearce, president, who has been active in insurance circles since the early fifties. He is similarly identified with the parent life carrier, Association Life Insurance Company, Inc., and International Harvester's intermediate holding company, Harco Holdings, Inc. The two insurance enterprises maintain joint administrative offices in Milwaukee, Wis.

Adverse conditions in the automotive industry last year was reflected by a sharp drop in premium production as a principle source of the company's business is a book of automobile physical damage insurance on financed vehicles and equipment. Direct or originated writings of $15,923,000 last year compare with $21,584,000 in 1979 and $6,419,000 in 1975. The trend in the annual net or retained volumes was similar although the annual rate of growth varied due to altered reinsurance arrangements.

A unique feature of underwriting practices is the handling of policy contracts for terms of more than one year as evidenced by unearned premium reserves which are in excess of net premium writings.

Underwriting results for the five years of operations ended 1980 proved rewarding. Despite an indicated deficit of 8.4% in 1980 business over the full interval, 1976-1980 inclusive, developed a mean indicated underwriting profit margin equal to 3.0% of premium income.

Except for forty preferred and one common stock, valued at $2,842,323, and one short-term collateral loan carried at $500,000, investments at the year end were confined to bondholdings, comprising United States Government issues, par value $10,284,232, special revenue obligations, par value $2,680,000, and corporate obligations, carried at $11,418,422. A sizeable asset item, funds deposited with reinsurers of $5,361,713, was equal to 58% of policyholders' surplus.

A convention examination of the company's affairs was made as of December 31, 1979.

### BEST'S RATING

Based on our analysis of the current financial and operating performance, we assign the company our Contingent Policyholders' Rating of "A+" (Excellent). The financial size category is Class X. See preface.

Classification of Admitted Assets.—Bonds: U. S. Government, $10,242,532, 26.5%; special revenue, $2,681,539, 6.9%; railroad, $926,288, 2.4%; utility, $3,393,164, 8.8%; miscellaneous, $7,098,970, 18.4%; total bonds, $24,342,493, 63.1%; common stocks: miscellaneous, $95,025, 0.2%; preferred stocks: utility, $2,512,235, 6.5%; bank, $126,563, 0.3%; miscellaneous, $108,500, 0.3%; total preferred stocks, $2,747,298, 7.1%; collateral loans, $500,000, 1.3%; cash, $2,135,493, 5.5%; premium balances, $2,440,242, 6.3%; other assets, $6,335,866, 16.4%.

*Comparative Financial—Operating Statistics

| Year | Admitted Assets | Plyhldrs Surp | Unearned Prems | Net Prems Writ | †Loss Ratio | ‡Exp Ratio | Und Results | Net Inv Inc | Fed Taxes Inc | Divs Decl |
|---|---|---|---|---|---|---|---|---|---|---|
| 78 | 1,969 | 1,925 | 34 | 36 | 29.6 | 163.7 | -57 | 30 | . . . | . . . |
| 79 | 2,242 | 1,481 | 469 | 853 | 79.8 | 71.3 | -538 | 150 | . . . | . . . |
| 80 | 3,425 | 429 | 806 | 1,645 | 68.7 | 52.4 | -445 | 211 | . . . | . . . |
| Totals and Averages |  |  |  | 2,564 | 71.5 | 60.5 | -1,041 | 390 | . . . | . . . |

*Last 000 omitted. Policyholders' surplus as filed excluding Conditional Reserve Funds. †Loss incurred to earned premiums ‡Incurred to written premiums

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# THE CONTINENTAL INSURANCE COMPANY

Concord, New Hampshire

**Admin. Office:** 80 Maiden Lane
**Mail Address:** 80 Maiden Lane
New York, N.Y. 10038
**Telephone No.:** 212-440-3000
**Data Bank No.:** 02118

## ADMITTED ASSETS

|  | Dec. 31, 1980 | Dec. 31, 1979 |
|---|---|---|
| Bonds: Amortized value | $371,366,175 | $366,906,589 |
| Stocks: Cost | (193,505,756) | (205,429,814) |
| Authorized value | 377,880,670 | 356,193,053 |
| Mortgages | 2,280,000 | 2,328,000 |
| Real estate | 14,009,000 | 14,517,000 |
| Collateral loans | 1,317,937 | 2,380,474 |
| Cash | 57,975,910 | 42,355,535 |
| Premium balances | 101,777,645 | 86,959,459 |
| Funds dep. with reinsured cos. | 8,630,827 | 24,747,292 |
| Bills receivable | 3,326,279 | 3,805,777 |
| Reinsurance recoverable | 65,785,814 | 40,141,339 |
| Accrued interest | 13,260,552 | 11,814,945 |
| Association accounts | 89,792,152 | 118,554,507 |
| Accounts receivable | 22,397,850 | 12,274,795 |
| EDP equipment | 11,141,013 | 7,294,652 |
| Foreign exchange adj | 143,707 | . . . |
| Other assets | 5,429,670 | 6,259,786 |
| Assets (statement) | $1,146,515,201 | $1,096,533,203 |

## LIABILITIES

|  | Dec. 31, 1980 | Dec. 31, 1979 |
|---|---|---|
| Losses-adj. exp. reserves | $549,969,349 | $500,967,966 |
| Commissions | 10,309,812 | 9,228,187 |
| Expenses, taxes, etc. | 9,355,393 | 8,645,403 |
| Federal income taxes | 37,990 | 37,990 |
| *Unearned premiums | 232,966,898 | 213,589,826 |
| Dividends to policyholders | 4,841,532 | 5,335,978 |
| Reinsurance treaty funds | 4,392,387 | 29,863,067 |
| Amount held for others | 35,253,404 | 33,416,791 |
| Accounts payable | 20,337,579 | 41,942,747 |
| Affiliated company balances | 11,259,840 | 27,705,965 |
| Loss drafts and balances | 1,411,806 | 3,493,724 |
| Employees pension & welfare | 8,887,819 | 2,491,510 |
| Payable securities transactions | 438,927 | . . . . |
| Ceded reins. balances payable | 22,910,535 | 33,460,539 |
| Other liabilities | . . . . | 252,606 |
| †Excess statutory loss reserve | 4,754,992 | 18,355,647 |
| Total Liabilities | $917,158,260 | $928,807,946 |
| Capital paid up | 53,566,360 | 53,566,360 |
| Net surplus | 175,790,581 | 114,158,897 |
| Total | $1,146,515,201 | $1,096,533,203 |

†Conditional Reserve Funds. See preface. *Includes for 1980 and 1979, rate and retrospective returns $7,997,053, $7,949,710.

## HISTORY

This company was formed under the laws of the State of New Hampshire on June 1977 to act as the vehicle for the transfer of corporate domicile of the Continental Insurance Company from New York, N.Y., to Concord, N.H. The arrangement, effected December 31, 1977, involved no change in financial or managerial positions of the company and merely represented the perpetuation of The Continental Insurance Company under a New Hampshire charter. The predecessor company was organized under the laws of the State of New York and began business in January 1853 with paid-in capital of $500,000 (par value $100 per share). In July 1871 the capital was increased to $1,000,000 by the sale of new stock. Stockholders in 1872 were assessed 40% as a result of losses sustained in the Boston conflagration of November 9, 1872.

Capital changes follow:

| Date | —Capital Changes— From | To | Surplus Contribution | Par Value | Issued Price |
|---|---|---|---|---|---|
| 1910-59 | $1,000,000 | $59,991,450 | A$404,206,743 | A | A |
| 1962 | 59,991,450 | 62,991,020 | . . . . | Stock | Dividend |
| 1965 | 62,991,020 | 60,000,000 | -38,118,362 | $5 | b |
| 1966 | 60,000,000 | 57,875,000 | -27,019,827 | 5 | b |
| 1967 | 57,875,000 | 55,500,000 | -34,897,027 | 5 | b |
| 1968 | 55,500,000 | 53,566,360 | -29,275,004 | 5 | b |
| 1976 | 53,566,360 | 53,566,360 | c17,118,375 | 5 | . . . . |
| 1977 | 53,566,360 | 53,566,360 | d11,611,408 | 5 | . . . . |

(A) Alterations in capital structure marked. Sale of new shares; stock splits, stock dividends; reduction and increase in par value of shares; shares issued in exchange for shares of other companies including Fidelity and Casualty Company, Fidelity-Phenix Fire Insurance Company (subsequently absorbed), Firemen's Insurance Company of Newark, N.J., and its affiliates (Commercial Insurance Company of Newark, N.J.; Metropolitan Casualty Insurance Company of New York, now The Glens Falls Insurance Company, Milwaukee Insurance Company, now National Ben Franklin Life Insurance Corporation; National-Ben Franklin Insurance Company of Pittsburgh, Pa., and Royal General Insurance Company of Canada), and Niagara Fire Insurance Company. Descriptive details are available upon request.

(b) Stock Purchase and Redemption Plan. Company acquired treasury shares as follows: 1965, 559,204 shares at average price of $68.72 per share, 1966, 425,000 shares at average price of $68.58 per share, 1967, 475,000 shares at average price of $78.47, 1968, 386,728 shares at average price of $80.70 per share. Shares so acquired were cancelled and retired at the annual stockholders' meeting of the following year. (c) Surplus contribution comprising 4,481,250 shares of Phoenix Assurance Company, Ltd. (England). (d) Surplus contribution in the form of 1,000 shares of Insco Systems Corporation, which was immediately liquidated.

The company transferred to the parent organization, by dividends: (1) Approximately $465,000,000 paid December 19, 1969 in the form of securities including its stock interests (indicated in parentheses) in Firemen's Insurance Company of Newark, New Jersey (99.19%), Buckeye Union Insurance Company (100%), and The National Reinsurance Corporation (100%); and (2) approximately $430,000,000 paid February 1, 1974, also in the form of securities, including its entire stock interests (100% except as noted) in: Boston Old Colony Insurance Company; The Fidelity and Casualty Company of New York; The Glens Falls Insurance Company; Kansas City Fire and Marine Insurance Company; National-Ben Franklin Insurance Company of Illinois; Niagara Fire Insurance Company; Seaboard Fire & Marine Insurance Company; Phoenix Assurance Company, Ltd. (25%), Phoenix Continental S.A. (56.5%), and Phoenix of Jamaica Assurance, Ltd. (19.4%).

Glens Falls Insurance Company, Glens Falls, N.Y. (a former wholly-owned subsidiary acquired in 1968) was absorbed by merger on January 1, 1971.

A former affiliate, Jersey Insurance Company of New York (acquired in early 1969), was sold on May 10, 1972 to GAC Finance, Inc., Allentown, Pa.

A change in the overall group financial structure was accomplished on August 15, 1968 when financial control of The Continental Insurance Company was acquired by The Continental Corporation, a holding company. Former stockholders of the insurance company (42,000 in number) received 8 shares of common and one share of Series A preferred in the new holding company for every 4 shares of The Continental Insurance Company previously held. Untendered shares (0.6%) were purchased for cash in 1969 at a price of $101 each. The boards of directors and principal officers of the holding company and insurance carrier are virtually identical.

## MANAGEMENT

The company heads The Continental Insurance Companies, which constitutes one of the more prominent groups of insurance carriers in the world. Management of the group is headed by John B. Ricker, Jr., chairman of the board and president.

The Continental Corporation, parent holding company of the group, holds total ownership of the Boston Old Colony Insurance Company (and its affiliate, Equitable Fire Insurance Company), The Buckeye Union Insurance Company, The Continental Insurance Company, The Fidelity and Casualty Company of New York, Firemen's Insurance Company of Newark, New Jersey, Kansas City Fire & Marine Insurance Company, National Ben Franklin Insurance Company of Illinois (and its affiliate, National-Ben Franklin Insurance Company of Michigan), Niagara Fire Insurance Company and Continental Reinsurance Corporation (Bermuda) Limited.

The Continental Insurance Company directly owns financial control of The National Life Assurance Company of Canada (99.5%) and of The Continental Insurance Company (Europe) Ltd., a holding company which owns The Continental Insurance Company (U.K.) Ltd., a property-casualty insurer.

EXHIBIT D

Subsidiaries of Firemen's Insurance Company of Newark, New Jersey, are: Buffalo Reinsurance Company (100%), Commercial Insurance Company of Newark, New Jersey (100%), Continental Reinsurance Corporation (100%), The Dominion Insurance Corporation (100%), The Glens Falls Insurance Company (100%), National-Ben Franklin Life Insurance Corporation (100%), and The Continental Insurance Company of Canada (100%).

Other financially related but independently operated companies are: The National Reinsurance Corporation, New York, N.Y., First Insurance Company of Hawaii, Ltd., and Swett & Crawford, Los Angeles, Cal., and its affiliates, Harbor Insurance Company and Pacific Insurance Company, wholly-owned by The Continental Corporation; American Title Insurance Company, Miami, Fla. (99.89% owned by The Continental Corporation), and its title subsidiaries, Columbia Real Estate Title Insurance Company, Texas Title Guaranty Company, Inc., and The Title Insurance Corporation of Pennsylvania; Puerto Rican American Corporation (98.2% owned by The Continental Corporation), which has 100% ownership of Puerto Rican-American Insurance Company and Preferred Risk Insurance Company.

The Continental Corporation directly and indirectly, has a substantial minority interest (20.6% of the outstanding shares) in Phoenix Assurance Company, Ltd., London, England. Through this connection The Continental Insurance Companies have the benefit of the worldwide multiple line underwriting facilities, including life, of the Phoenix. Subsidiaries of that company include Phoenix Assurance Company of New York and London Guarantee and Accident Company of New York.

The Continental Corporation sold a substantial minority interest (27.5%) of the Franklin Life Insurance Company in 1977.

Other foreign insurance enterprises in which majority ownership is held by The Continental Corporation through which it conducts worldwide operations include: Bayside Reinsurance Company Ltd. (Bermuda), Commercial Aseguradora Suizo Americana, S.A. (Guatemala), Continental Reinsurance Corporation, Ltd. (Bermuda), The Ivanhoe Reinsurance Company, Ltd. (Bermuda), The Ivanhoe Reinsurance Company, Ltd. (Britain), The London Security Reinsurance Company, Ltd. (Britain), Phoenix Brasileira Cia de Seguros Gerais (Brazil), Phoenix Continental, S.A. (Belgium), Phoenix Latino, S.A. (Spain), Phoenix of Jamaica Assurance Company, Ltd. (Jamaica), Unionamerica Insurance Company, Limited (Britain), and Verzekering Maatschappij Minerva, N.V. (Netherlands).

Equity interests are also maintained in: Alte Leipziger Versicherungs A.G. (Germany), Asia Insurance Company (Hong Kong), Continental Hellas, S.A. (Greece), Hafez Insurance Company, Ltd. (Iran), Insurance Corporation of Ireland, Ltd. (Ireland), La Intercontinental de Seguros, S.A. (Dominican Republic), Malayan Overseas Insurance Corporation (Taiwan), Pan-Malayan Insurance Corporation (Philippines), La Preservatrice Compagnie Anonyme d'Assurance A.I.R.D. (France), Seguros Universales, S.A. (Guatemala), Societe Nouvelle d'Assurances du Cameroun, S.N.A.C. (Cameroun), Sud Atlantica Compania de Seguros, S.A. (Argentina), United Continental Insurance Sdn. Bhd. (Malaysia), La Venezolana de Seguros, S.A. (Venezuela) and United Asia Reinsurance Corporation (Singapore).

Domestic members of The Continental Insurance Companies enjoy the distinction of ranking among the ten leading companies and groups in the writing of property and casualty business. Total consolidated assets and policyholders' surplus funds of domestic property and casualty members of the group, as of December 31, 1980 amounted to $5,777,948,000 and $1,334,915,000, respectively. Combined net premium writings in 1980 were $2,781,195,000.

A sound financial position is maintained and assumed underwriting commitments are reasonable in relation to net resources. Growth of business reflects a careful program of expansion. Generally favorable underwriting activities were enjoyed in three of the past five years (1977-1979, inclusive) as evidenced by an average annual profit margin equal to 2.4% of premiums. These experiences were preceded and followed by adverse experiences as reflected by the indicated deficits of 7.0% in 1976 and 6.3% in 1980. These results reflected, to a major degree, generally adverse conditions throughout the industry. The favorable results for the intermediate interval were more in accord with normal accomplishments. Policyholders' surplus and special funds at the year end of $234,112,000 compare with the $186,081,000 possessed a year earlier, $216,389,000 as the close of 1978 and $203,059,000 at the close of 1975. Shrinkage in 1979 was solely attributal to the charge-off of $48,536,649 of assets previously admitted.

A joint convention examination of the company's affairs is being made as of December 31, 1979.

## BEST'S RATING

Based on our analysis of the current financial and operating performance, we assign the company our Policyholders' Rating of "A +" (Excellent), which is a group rating assigned members of the Continental Insurance Companies operating under a group business pooling arrangement. The financial size category is Class XV. See preface.

## GENERAL UNDERWRITING POLICY

The company and companion carriers subscribe to the rates and rules and are members of virtually all board and bureau underwriting associations. Operations are conducted nationwide, in Canada, Canal Zone and elsewhere in the world. A multiple line business is transacted through the services of agents. Regional offices with complete underwriting authority are maintained in Atlanta, Chicago, Columbus, Dallas, Livingston (NJ), San Francisco and Toronto. For servicing international business the company maintains a worldwide service network.

All property and casualty business written by domestic members of The Continental Insurance Companies (excluding the Buffalo Reinsurance Company, Continental Reinsurance Corporation, Harbor Insurance Company, National-Ben Franklin Insurance Company of Michigan and First Insurance Company of Hawaii, Ltd.) is subject to an underwriting pooling operation. Since January 1, 1968, all direct premiums of the Phoenix of London Group also have been pooled and shared by contributing companies. The Tokio Marine and Fire Insurance Company, Limited, and the Phoenix of London Group share to the extent of 0.75% and 6%, respectively. The remaining pooled premiums are apportioned among ten members of The Continental Insurance Companies. The participations as of December 31, 1978 were as follows: Boston Old Colony Insurance Company, 1%; The Buckeye Union Insurance Company, 21%; Commercial Insurance Company of Newark, New Jersey, 5%; The Continental Insurance Company, 25%; The Fidelity and Casualty Company of New York, 9%; Firemen's Insurance Company of Newark, New Jersey, 26%; The Glens Falls Insurance Company, 2%; Kansas City Fire and Marine Insurance Company, 1%; National-Ben Franklin Insurance Company of Illinois, 1%; and Niagara Fire Insurance Company, 2%.

All Canadian property and casualty business is also subject to an intercompany business pooling arrangement and prorated between the Canadian affiliates (Dominion Insurance Corporation and Continental Insurance of Canada), The Continental Insurance Company and Niagara Fire Insurance Company.

The marine business of The Continental Insurance Companies is managed by Marine Office of America Corporation in which The Continental Corporation and The Continental Insurance Company have stock interests of 81% and 12%, respectively.

Writings of the company include participations in business underwritten or serviced by Associated Aviation Underwriters, Crop Insurance Group, Excess & Casualty Reinsurance Association, Excess Underwriters, Foreign Credit Insurance Association, Industrial Risk Insurers, Stock Company Association and Underwriters Service Association, of which the company is a member.

Direct premium writings in 1980 were distributed in thousands as follows: Ala., 9,283; Alaska, 6,158; Ariz., 19,136; Ark., 8,732; Cal., 175,006; Colo., 8,236; Conn., 13,651; Del., 2,930; D.C., 2,695; Fla., 46,451; Ga., 33,773; Hawaii, 2,174; Idaho, 4,890; Ill., 25,895; Ind., 27,358; Iowa, 8,616; Kan., 10,464; Ky., 35,500; La., 43,859; Me., 5,386; Md., 19,933; Mass., 21,657; Mich., 22,816; Minn., 21,121; Miss., 5,050; Mo., 26,377; Mont., 5,994; Neb., 9,203; Nev., 2,818; N.H., 2,086; N.J., 51,633; N.M., 554; N.Y., 94,353; N.C., 12,065; N.D., 2,656; Ohio, 24,030; Okla., 2,642; Ore., 8,096; Pa., 11,811; R.I., 4,119; S.C., 16,203; S.D., 1,309; Tenn., 6,359; Texas, 12,439; Utah, 3,203; Vt., 3,174; Va., 14,510; Wash., 22,883; W. Va., 2,355; Wis., 19,196; Wyo., 2,975; P.R., 668; Can., 86,370; Foreign, 56,567.

### (A) By-Line Underwriting Results

| | Fire | | | Allied Lines | | | ‡Homeowners | | |
|---|---|---|---|---|---|---|---|---|---|
| Year | *Prem Earned | †Loss Ratio | †Exp Ratio | *Prem Earned | †Loss Ratio | †Exp Ratio | *Prem Earned | †Loss Ratio | †Exp Ratio |
| 1976 | 133,051 | 61.6 | 32.9 | 54,552 | 51.9 | 33.3 | 174,960 | 70.5 | 32.1 |
| 1977 | 129,010 | 54.5 | 32.6 | 53,409 | 42.3 | 33.2 | 197,642 | 55.9 | 31.6 |
| 1978 | 119,187 | 53.4 | 36.0 | 58,911 | 58.2 | 35.7 | 214,547 | 60.8 | 33.7 |
| 1979 | 118,036 | 58.5 | 37.5 | 60,512 | 55.2 | 36.7 | 237,099 | 73.1 | 34.2 |
| 1980 | 106,084 | 60.6 | 34.6 | 58,920 | 77.5 | 35.5 | 253,744 | 75.6 | 34.9 |

| | Com'l Multi. Peril | | | Ocean Marine | | | Inland Marine | | |
|---|---|---|---|---|---|---|---|---|---|
| Year | *Prem Earned | †Loss Ratio | †Exp Ratio | *Prem Earned | †Loss Ratio | †Exp Ratio | *Prem Earned | †Loss Ratio | †Exp Ratio |
| 1976 | 174,426 | 59.2 | 31.1 | 110,040 | 68.4 | 22.7 | 64,451 | 56.1 | 27.8 |
| 1977 | 179,667 | 56.2 | 31.4 | 114,622 | 75.4 | 23.6 | 71,947 | 51.6 | 27.2 |
| 1978 | 202,717 | 51.3 | 32.6 | 102,910 | 65.3 | 23.8 | 81,800 | 57.0 | 27.8 |
| 1979 | 223,997 | 56.6 | 34.7 | 105,458 | 84.1 | 25.1 | 81,423 | 59.6 | 30.0 |
| 1980 | 237,279 | 61.2 | 35.6 | 115,617 | 80.6 | 27.3 | 90,856 | 65.3 | 33.4 |

| | Other A & H | | | Workers Comp. | | | §Misc. Liability | | |
|---|---|---|---|---|---|---|---|---|---|
| Year | *Prem Earned | †Loss Ratio | †Exp Ratio | *Prem Earned | †Loss Ratio | †Exp Ratio | *Prem Earned | †Loss Ratio | †Exp Ratio |
| 1976 | 49,112 | 65.1 | 31.7 | 268,521 | 104.5 | 17.0 | 174,621 | 115.1 | 24.5 |
| 1977 | 49,240 | 68.7 | 36.1 | 246,608 | 89.9 | 17.6 | 172,268 | 75.4 | 26.9 |
| 1978 | 51,083 | 66.4 | 31.9 | 244,134 | 82.6 | 18.3 | 156,901 | 71.9 | 29.7 |
| 1979 | 51,319 | 70.0 | 33.0 | 258,230 | 90.8 | 19.8 | 140,309 | 93.7 | 32.7 |
| 1980 | 52,940 | 74.9 | 32.6 | 302,849 | 83.9 | 18.6 | 143,406 | 103.7 | 28.7 |

## THE CONTINENTAL INSURANCE COMPANY—Continued

| | Auto Liability | | | Auto Physical | | | Fidelity | | |
|---|---|---|---|---|---|---|---|---|---|
| Year | *Prem Earned | †Loss Ratio | †Exp Ratio | *Prem Earned | †Loss Ratio | †Exp Ratio | *Prem. Earned | †Loss Ratio | †Exp Ratio |
| 1976 | 332,838 | 85.6 | 26.6 | 186,105 | 77.1 | 28.1 | 14,363 | 65.4 | 30.7 |
| 1977 | 360,507 | 71.8 | 27.4 | 195,595 | 65.2 | 27.8 | 14,115 | 95.3 | 32.1 |
| 1978 | 384,904 | 69.9 | 29.3 | 205,462 | 65.0 | 29.9 | 13,871 | 75.9 | 39.5 |
| 1979 | 386,137 | 69.5 | 29.8 | 219,339 | 71.9 | 29.9 | 16,554 | 59.7 | 38.9 |
| 1980 | 412,037 | 80.6 | 29.8 | 243,957 | 72.6 | 30.1 | 15,953 | 75.1 | 40.4 |

| | Surety | | | Burglary & Theft | | | Boiler & Mach. | | |
|---|---|---|---|---|---|---|---|---|---|
| Year | *Prem Earned | †Loss Ratio | †Exp Ratio | *Prem Earned | †Loss Ratio | †Exp Ratio | *Prem. Earned | †Loss Ratio | †Exp Ratio |
| 1976 | 12,008 | 10.3 | 44.6 | 4,385 | 41.4 | 36.9 | 8,243 | 39.6 | 48.4 |
| 1977 | 12,510 | 36.3 | 42.7 | 3,390 | 33.5 | 38.8 | 7,300 | 39.3 | 52.1 |
| 1978 | 14,314 | 28.4 | 50.3 | 3,544 | 31.1 | 36.5 | 8,546 | 28.8 | 45.7 |
| 1979 | 16,449 | -2.8 | 55.7 | 3,565 | 30.8 | 41.0 | 8,613 | 14.2 | 46.9 |
| 1980 | 19,135 | 34.2 | 47.1 | 3,322 | 43.0 | 36.0 | 9,125 | 30.3 | 39.9 |

*Last 000 omitted. †Losses and claim adj. expenses incurred to earned, underwriting expenses incurred to written. (A) Group basis. Combined returns of this company and domestic property-casualty members of "The Continental Insurance Companies." ‡Includes homeowners. §Includes medical malpractice.

**Classification of Admitted Assets.**—Bonds: U. S. Government, $14,898,374, 1.3%; other government, $39,828,235, 3.5%; state, municipal, etc., $38,821,021, 3.4%; special revenue, $225,062,409, 19.6%; utility, $3,005,721, 0.3%; miscellaneous, $49,750,411, 4.3%; total bonds, $371,366,175, 32.4%; common stocks: utility, $11,046,553, 1.0%; bank, $29,673,295, 2.6%; insurance, $62,953,650, 5.5%; miscellaneous, $166,816,755, 14.5%; parents, subsidiaries, and affiliates, $64,407,274, 5.6%; total common stocks, $334,897,528, 29.2%; preferred stocks: railroad, $151,500, . . . .%; utility, $40,084,620, 3.5%, miscellaneous, $2,747,021, 0.2%; total preferred stocks, $42,983,142, 3.7%; mortgages, $2,280,000, 0.2%; real estate, $14,009,000, 1.2%; collateral loans, $1,317,937, 0.1%; cash, $57,975,910, 5.1%; premium balances, $101,777,645, 8.9%; other assets, $219,907,864, 19.2%.

Bonds are high-grade issues and well diversified. Notable blocks are: U.S. Government obligations, par value $16,445,000, other Government bonds par value, $40,984,293; special revenue obligations, par value $237,419,000, and utility, industrial and miscellaneous issues, carried at $52,756,132.

Stockholdings in affiliated companies at the year end included: 666,600 shares of Continental Insurance Company Europe carried at $2,998,983; 1,214 shares of Maiden Lane Syndicate valued at $1,211,147; 2,400 shares of Marine Office of America Corporation carried at $588,144; 99,681 shares of The National Life Assurance Company of Canada valued at $58,109,000, 100 shares of 180 Group, Inc. carried at $1,500,000, and 10,201,250 shares of Phoenix Assurance Company, Ltd. (England) valued at $62,533,662.

Prominent blocks of stock issues (with a year end market value in excess of $10,000,000) directly held by the company were: 383,200 preferred and 210,782 common American Telephone and Telegraph; 741,852 Amerada Hess Corp.; 1,192,668 Citicorp; 798,884 International Business Machines; 665,200 St. Joe Minerals Corp. and 227,700 Shell Oil Corp.

**Territory.**—It is licensed in D.C., Puerto Rico and all states. It is also licensed in the Bahamas, Bermuda, Canada, Dominican Republic, England, France, Guam, Haiti, Holland, Japan, Panama, Spain (reinsurance) and U.S. Virgin Islands.

**Dividend Record.**—Paid continuously since organization. Total dividends declared since organization: Stock, $24,452,075, cash, $1,710,346,783.

**Officers.**—Chairman of the board and president, John B. Ricker, Jr.; president, John Pierre Mascotte, executive vice presidents, John H. Brethenck, Jr., Harold E. Johnson; senior vice presidents, Arnold C. Avitable, J. Dean Cassidy, H. Donald Lindell, Max R. Nunnery, Mervyn J. Walding; vice president and secretary, William F. Gleason, Jr.; vice president and treasurer, Leighton M. Lobdell; vice president and controller, Francis M. Colalucci; vice president and senior actuary, Philip N. Ben-Zvi; vice president and general counsel, William S. Gibson.

Vice presidents and regional managers: C. Ben Buck, Jr. (Western, Chicago), Alan N. Dekker (Buckeye, Columbus), John W. O'Connor (Pacific, San Francisco), Robert R. Barsanti (Southwestern, Dallas), Richard A. Simon (Eastern, New York), William W. Ward (Canadian, Toronto).

Vice presidents, Harold Y. Bain, Harold G. Culler, Robert H. Dorgan, John W. Downs, Martin D. Farrell, Morris L. Ford, John D. Gaertner, Woodley D. Gordon, David I. Hardin, Marcel J. Koster, John H. Loynes, James E. Marron, John H. Minner, Henry I. Moore, John R. Moran, Robert K. Nelson, John H. Nordlund, Edward A. O'Neill, Clifford H. Philo, Roderick C. Rasmussen, Richard B. Schommer, George M. Silvis (medical director), Zane D. Smith, Lisle J. Switzer, Walter L. Tarver, Beverly B. Wadsworth, John L. Wallace, Allen P. Willis, Jr.

**Directors.**—Charles F. Barber, Drummond C. Bell, Jerome H. Holland, Harold E. Johnson, Allen T. Lambert, Ralph F. Leach, Robert D. Lilley, John F. McGillicuddy, John B. Ricker, Jr., Clifford D. Siverd, L. Edwin Smart, Patricia C. Stewart, Michael Weintraub, F. Perry Wilson, George G. Zipf.

### 1980 Premiums—Losses

| Kinds of Insurance | *Direct Premiums Written | *Net Premiums Written | *Case Loss & Exp. Res. Year-End | *Net Premiums Earned | ‡Pure Loss Ratio 1980 | ‡Pure Loss Ratio 1979 |
|---|---|---|---|---|---|---|
| Fire | $75,701 | $25,652 | $14,506 | $26,521 | 57.7 | 56.1 |
| Allied Lines | 35,217 | 14,179 | 3,905 | 14,730 | 73.1 | 54.1 |
| Farmowners | 14,317 | 9,257 | 2,667 | 8,901 | 74.8 | 53.7 |
| Homeowners | 95,965 | 57,414 | 19,011 | 54,526 | 68.6 | 65.1 |
| Com'l Multi Peril | 115,514 | 62,009 | 49,060 | 59,319 | 51.6 | 47.3 |
| Ocean Marine | 120,145 | 29,416 | 28,979 | 28,904 | 74.7 | 78.0 |
| Inland Marine | 55,296 | 22,833 | 8,891 | 22,714 | 60.7 | 54.0 |
| Group A & H | 29,541 | 10,430 | 14,332 | 9,991 | 79.4 | 71.5 |
| Other A & H | 3,085 | 13,340 | 10,672 | 13,210 | 72.9 | 69.6 |
| Workers Compensation | 122,620 | 78,524 | 146,269 | 75,725 | 74.1 | 78.5 |
| Misc. Liability | 91,141 | 33,830 | 104,404 | 34,563 | 77.5 | 60.1 |
| Auto Liability | 170,504 | 108,496 | 106,536 | 103,009 | 69.1 | 59.2 |
| Auto Physical | 97,903 | 65,892 | 10,504 | 60,989 | 64.6 | 63.2 |
| All Other | 60,213 | a21,026 | 30,234 | 19,839 | . . . | . . . |
| Totals | $1,087,482 | $552,328 | $549,969 | $532,951 | 67.1 | 61.4 |

*Figures in thousands. ‡Incurred to earned premiums. (a) Distribution in dollars: Medical malpractice, 1,361,110, earthquake, 609,784, credit a&h, 11,280, aircraft (all perils), 4,205,774, fidelity, 4,544,828, surety, 4,930,437, glass, [illegible]7,118; burglary & theft, 806,7[illegible]8; boiler & machinery, 2,405,485, credit, 2,013,018.

### Underwriting Income and Disbursements, 1980

| | |
|---|---|
| Premiums written: Direct, $1,087,482,159; reinsurance assumed, $1,934,169,095; reinsurance ceded, $2,469,323,353; net | $552,327,901 |
| Losses paid: Direct, $625,220,651; reinsurance assumed, $1,097,909,830; reinsurance recovered, $1,408,302,285, net | $314,828,196 |
| Loss adjustment expenses paid | $42,208,322 |
| Underwriting expenses incurred—Commissions: Direct, $165,121,195; reinsurance assumed, $301,970,736; reinsurance ceded, $386,732,570; contingent, $7,723,508; commissions—net, $88,082,869; salaries, $35,160,456; taxes, licenses, fees, $13,157,517, all others, $30,031,760; total | $166,432,602 |

### Underwriting Account, 1980, before Federal Taxes

| Gains: | | Losses: | |
|---|---|---|---|
| Prems. earned | $532,950,830 | Losses inc'd | $357,505,662 |
| Und. loss | 41,664,057 | Adj. exp. inc'd | 48,532,240 |
| | | Und. exp. inc'd | 166,432,602 |
| | | Prem. balance | 2,144,383 |
| Total | $574,614,887 | Total | $574,614,887 |

### Investment Account, 1980, before Federal Taxes

| Gains: | | Losses: | |
|---|---|---|---|
| Inv. income | $57,066,813 | Inv. exp. inc'd | $2,054,649 |
| Appreciation | 31,857,260 | Inv. gain | 100,976,223 |
| Sales | 14,106,799 | | |
| Total | $103,030,872 | Total | $103,030,872 |

### Policyholders' Surplus Account, 1980

| Additions: | | Deductions: | |
|---|---|---|---|
| Pol. sur. 1979 | $167,725,257 | Federal inc. tax | $-1,282,566 |
| Inv. gain | 100,976,223 | Und. loss | 41,664,057 |
| Assets non-ad. | 24,765,391 | Foreign exchange | 1,043,940 |
| Loss res. adj. | 13,600,655 | Div. stockholders | 34,282,470 |
| Other items | 35,838 | Div. plyhldrs. | 2,038,522 |
| | | Pol. sur. 1980 | 229,356,941 |
| Total | $307,103,364 | Total | $307,103,364 |

### COMPARATIVE FINANCIAL AND OPERATING EXHIBIT

All figures except ratios in thousands

| | Asset % | | FINANCIAL | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| Year | Cash & Bonds | Stock | Total Admitted Assets | Reported Policyholders' Surplus | Special Funds | Case Loss Reserves | Unearned Prems. | Direct Prems. Written | Net Prems. Written |
| 1976 | 31 | 40 | 755,814 | 177,696 | 40,250 | 244,293 | 109,288 | 728,019 | 270,249 |
| 1977 | 28 | 31 | 969,196 | 176,395 | 22,821 | 446,839 | 192,645 | 763,701 | 363,673 |
| 1978 | 41 | 33 | 1,095,613 | 205,323 | 11,066 | 459,996 | 201,670 | 886,250 | 489,421 |
| 1979 | 37 | 32 | 1,096,533 | 167,725 | 18,356 | 500,968 | 213,590 | 965,451 | 508,867 |
| 1980 | 37 | 33 | 1,146,515 | 229,357 | 4,755 | 549,969 | 232,967 | 1,087,482 | 552,328 |
| Totals and Averages | | | | | | | | 4,420,904 | 2,184,538 |

| | OPERATING—Before Federal Taxes | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| Year | Net Prems. Earn. | Losses Inc. to Prems. Earn. | Exp. Inc. to Prems. Writ. | Comb. Loss and Exp. | Underwriting Profit or Loss | Net Investment Income | Other Invest. Gains or Losses | Federal Taxes Incurred | Dividends Declared (p) |
| 1976 | 263,005 | 80.2 | 26.9 | 107.0 | -20,693 | 23,859 | 14,695 | 800 | 15,651 |
| 1977 | 280,316 | 68.8 | 27.5 | 96.2 | -12,691 | 30,402 | -5,378 | 3,393 | 17,269 |
| 1978 | 480,396 | 65.3 | 29.2 | 94.5 | 22,983 | 43,065 | 6,018 | 15,201 | 24,624 |
| 1979 | 496,947 | 71.1 | 30.5 | 101.6 | -12,007 | 51,023 | 6,755 | -1,070 | 27,822 |
| 1980 | 532,951 | 76.2 | 30.1 | 106.3 | -41,664 | 55,012 | 45,964 | -1,283 | 36,321 |
| | 2,053,615 | 71.9 | 29.2 | 101.1 | -64,073 | 203,360 | 68,054 | 17,042 | 121,687 |

(p) Includes dividends to policyholders: 1976, $1,938,242; 1977, $2,070,725; 1978, $3,197,754; 1979, $2,109,716; 1980, $2,038,522; balance to stockholders.

◆

## CONTINENTAL REINSURANCE CORPORATION

San Francisco, California

**Admin. Office:** 80 Maiden Lane
**Mail Address:** 80 Maiden Lane
New York, N.Y. 10038
**Telephone No.:** 212-440-3000
**Data Bank No.:** 02299

### ADMITTED ASSETS

| | Dec. 31, 1980 | Dec. 31, 1979 |
|---|---|---|
| Bonds: Cost | ($92,006,025) | ($62,348,565) |
| Amortized value | 92,322,122 | 62,875,298 |
| Stocks: Cost | (72,277,480) | (92,265,258) |
| Authorized value | 98,4 6,954 | 99,999,105 |
| Cash | 6,0 6,225 | 3,223,934 |
| Premium balances | 1,636,019 | 289,908 |
| Funds dep. with reinsured cos. | 20,151,544 | 15,488,640 |
| Reinsurance recoverable | 13,732,160 | 5,754,827 |
| Accrued interest | 1,75 ,221 | 1,565,440 |
| Rec. security transactions | 527,935 | 409,620 |
| Accounts receivable | 2,907,208 | 1,100,074 |
| Assets (statement) | $237,523,388 | $190,706,846 |

### LIABILITIES

| | Dec. 31, 1980 | Dec. 31, 1979 |
|---|---|---|
| Losses-adj. exp. reserves | $68,454,762 | $56,506,532 |
| Commissions | .... | 446,857 |
| Expenses, taxes, etc. | 9,871 | 3,924 |
| Unearned premiums | 4,103,079 | 4,863,140 |
| Reinsurance treaty funds | 7,082,868 | 611,757 |
| Amount held for others | 1,380,350 | 28,296 |
| Foreign exchange adjustments | 105,617 | 288,617 |
| Accounts payable | 10,282,078 | 82,648 |
| Affiliated company balances | 3,745,156 | 8,200 |
| Ceded reins. balances payable | 22,998,804 | 12,769,288 |
| Other liabilities | 1,823,300 | 7,886,773 |
| †Unauthorized reinsurance | 6,279,362 | 4,841,978 |
| †Excess statutory loss reserve | 4,752,999 | 2,122,669 |
| Total Liabilities | $131,018,246 | $90,460,729 |
| Capital paid up | 1,500,000 | 1,500,000 |
| Net surplus | 105,005,142 | 98,746,117 |
| Total | $237,523,388 | $190,706,846 |

†Conditional Reserve Funds. See preface.

### HISTORY

This company was organized under the laws of California February 17, 1942 to reinsure the business of Guarantee Insurance Company, Ltd., Mutual, which commenced business July 2, 1936. The company was licensed in April 1942 with $100,000 capital and an equal amount of surplus. When financial control passed from the company's founder, J. R. Deering, and his associates on September 26, 1955 to The London Assurance, London, England, the capital had been increased to $351,000 by sale of additional shares, stock dividends and changes in the par value of shares.

Immediately after 1955 change in ownership the new sponsor contributed $3,250,000 of additional resources to the company. At the same time the capital was changed to $1,250,000.

Capital changes follow:

| | Capital Changes | | | | |
|---|---|---|---|---|---|
| Date | From | To | Surplus Contribution | Par Value | Issued Price |
| 1957 | $1,250,000 | $1,250,000 | a$2,500,000 | $100 | [illegible] |
| 1958 | 1,250,000 | 1,250,000 | b-500,000 | 100 | [illegible] |
| 1960 | 1,250,000 | 1,500,000 | ... | Stock | Dividend |
| 1961 | 1,500,000 | 1,500,000 | a20,627 | 150 | [illegible] |
| 1969 | 1,500,000 | 1,500,000 | a25,000,000 | 100 | [illegible] |
| 1973 | 1,500,000 | 1,500,000 | a130,000,000 | 100 | [illegible] |
| 1977 | 1,500,000 | 1,500,000 | b-29,000,000 | 100 | [illegible] |

(a) Surplus contribution. (b) Repayment of surplus contributions.

Operations were conducted under the title "Guarantee Insurance Company" from organization until July 22, 1969 when the name was changed to "Pacific Insurance Company." The present corporate title was adopted on January 3, 1978.

A former affiliate, Guarantee Insurance Company of Texas, in June 1969, was spun-off to the ISI Corporation which then sold the Pacific Insurance Company (formerly titled "Guarantee Insurance Company") to the Firemen's Insurance Company of Newark, New Jersey.

Ownership of the entire outstanding capital stock passed in 1961 from the London Assurance to its wholly-owned subsidiary, The Manhattan Fire and Marine Insurance Company. During 1967 the latter company reduced its interest to 80% through the exchange of 3,000 shares (20% of capital stock) to a closely related enterprise, U.S. Branch of the Sea Insurance Company, Ltd. for their interest in the American Sea Insurance Company (merged into Guarantee Insurance Company on December 31, 1967). This interest (3,000 shares) was purchased by ISI Corporation (a San Francisco, Cal., holding company) on December 30, 1968 and the remaining 80% acquired in early 1969. Ownership of that company rested with The Continental Insurance Company from late 1957 until December 18, 1969 at which time, by means of a dividend, it passed to The Continental Corporation, the parent holding company.

### MANAGEMENT

Management is directed by capable and experienced insurance executives, many of which were active in the administration of the reinsurance department maintained by The Continental Insurance Company. Joseph L. Fox, president since late 1980, has a broad background in reinsurance underwriting and administrative activities.

Ownership of the company resides with Firemen's Insurance Company of Newark, New Jersey, an affiliate of The Continental Corporation. The management and operations of the Continental Reinsurance Corporation and a companion enterprise, Continental Reinsurance Corporation (Bermuda) Limited, however, are completely autonomous and separate from those of the holding company and its other insurance affiliates.